



# **NAVAL POSTGRADUATE SCHOOL**

**MONTEREY, CALIFORNIA**

## **THESIS**

**IMPROVING RISK MANAGEMENT AND RESILIENCY: A  
PLAN FOR A PROACTIVE NATIONAL POLICY ON  
INSURANCE PRACTICES IN FEMA'S PUBLIC  
ASSISTANCE PROGRAM**

by

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December 2013

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<b>REPORT DOCUMENTATION PAGE</b>			Form Approved OMB No. 0704-0188	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington DC 20503.				
<b>1. AGENCY USE ONLY (Leave blank)</b>		<b>2. REPORT DATE</b> December 2013	<b>3. REPORT TYPE AND DATES COVERED</b> Master's Thesis	
<b>4. TITLE AND SUBTITLE</b> IMPROVING RISK MANAGEMENT AND RESILIENCY: A PLAN FOR A PROACTIVE NATIONAL POLICY ON INSURANCE PRACTICES IN FEMA'S PUBLIC ASSISTANCE PROGRAM			<b>5. FUNDING NUMBERS</b>	
<b>6. AUTHOR(S)</b> Gregory W. Eaton				
<b>7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES)</b> Naval Postgraduate School Monterey, CA 93943-5000			<b>8. PERFORMING ORGANIZATION REPORT NUMBER</b>	
<b>9. SPONSORING /MONITORING AGENCY NAME(S) AND ADDRESS(ES)</b> N/A			<b>10. SPONSORING/MONITORING AGENCY REPORT NUMBER</b>	
<b>11. SUPPLEMENTARY NOTES</b> The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government. IRB Protocol number ____N/A____.				
<b>12a. DISTRIBUTION / AVAILABILITY STATEMENT</b> Approved for public release; distribution is unlimited			<b>12b. DISTRIBUTION CODE</b> A	
<b>13. ABSTRACT (maximum 200 words)</b>  Disasters happen. The risks cannot be completely eliminated. However, the risks to insurable public infrastructure can be reduced or controlled through better federal guidance that shapes the value and importance of insurance in risk financing and improves mitigation utilization for risk control.  This thesis explores the areas where the federal guidance on insurance can be updated. The intent of Congress is clear. However, the federal guidance on insurance is dated, imprecise, and incentivizes poor risk management. Updated federal guidance can more accurately provide the appropriate incentives and disincentives to promote better risk management in the protection of insurable facilities. Federal policy must allow the flexibility to manage risk while encouraging sound insurance decision making by facility owners to reduce or eliminate the reliance of federal disaster assistance. This can be accomplished through the requirement of insurance, ineligibility of deductibles, flexibility in types of insurance, and promoting resiliency through incentives for hazard mitigation. By improving risk control for insurable infrastructure, we can begin to reduce the costs of disasters and increase the resiliency of communities across the nation.				
<b>14. SUBJECT TERMS</b> Insurance, Public Assistance, Disaster Assistance, FEMA Public Assistance, Public Assistance Policy,			<b>15. NUMBER OF PAGES</b> 229	
			<b>16. PRICE CODE</b>	
<b>17. SECURITY CLASSIFICATION OF REPORT</b> Unclassified	<b>18. SECURITY CLASSIFICATION OF THIS PAGE</b> Unclassified	<b>19. SECURITY CLASSIFICATION OF ABSTRACT</b> Unclassified	<b>20. LIMITATION OF ABSTRACT</b> UU	

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PROACTIVE NATIONAL POLICY ON INSURANCE PRACTICES IN FEMA'S  
PUBLIC ASSISTANCE PROGRAM**

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Submitted in partial fulfillment of the  
requirements for the degree of

**MASTER OF ARTS IN SECURITY STUDIES  
(HOMELAND SECURITY AND DEFENSE)**

from the

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## **ABSTRACT**

Disasters happen. The risks cannot be completely eliminated. However, the risks to insurable public infrastructure can be reduced or controlled through better federal guidance that shapes the value and importance of insurance in risk financing and improves mitigation utilization for risk control.

This thesis explores the areas where the federal guidance on insurance can be updated. The intent of Congress is clear. However, the federal guidance on insurance is dated, imprecise, and incentivizes poor risk management. Updated federal guidance can more accurately provide the appropriate incentives and disincentives to promote better risk management in the protection of insurable facilities. Federal policy must allow the flexibility to manage risk while encouraging sound insurance decision making by facility owners to reduce or eliminate the reliance of federal disaster assistance. This can be accomplished through the requirement of insurance, ineligibility of deductibles, flexibility in types of insurance, and promoting resiliency through incentives for hazard mitigation. By improving risk control for insurable infrastructure, we can begin to reduce the costs of disasters and increase the resiliency of communities across the nation.

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## LIST OF ACRONYMS AND ABBREVIATIONS

44 CFR	Title 44 of the Code of Federal Regulations
Act	The Robert T. Stafford Act
AIR	Applied Insurance Research
ANPR	Advance Notice Proposed Rulemaking process
Applicant	State Agency, Tribal Nation, local jurisdiction, and certain private nonprofits
Cat	Catastrophe
CDBG	Community Development Block Grant
CEA	California Earthquake Authority
CFR	Code of Federal Regulations
DAP	Disaster Assistance Policy
DFAA	Disaster Financial Assistance Arrangements (Canada)
DHS-OIG	Department of Homeland Security, Office of Inspector General
DoFD	Department of Finance and Deregulation (Australia)
DR	Major Disaster
EM	Emergency
EMA	Emergency Management Agency (Australia)
FEMA	Federal Emergency Management Agency
FIGA	Florida Insurance Guaranty Association
FY	Fiscal Year
GDP	Gross Domestic Product
Grantee	State government or Tribal Nation
HMGP	Hazard Mitigation Grant Program
HMP	Hazard Mitigation Plan
ILS	Insurance Linked Securities
NAIC	National Association of Insurance Commissioners
NDRRA	Natural Disaster Relief and Recovery Arrangements (Australia)
NEMA	National Emergency Management Agency
NFIP	National Flood Insurance Program
OIG	Office of Inspector General

O&M	Obtain and Maintain
PA	Public Assistance
Policy	FEMA Policy for Insurance
PS	Public Safety Canada
PW	Project Worksheet
SFHA	Special Flood Hazard Area
SFIC	Southern Family Insurance Company
SIR	Self-Insured Retention
SRIA	Sandy Recovery Improvement Act of 2013
USACE	United States Army Corps of Engineers
WYO	Write-Your-Own

## EXECUTIVE SUMMARY

In a holistic approach to risk management, insurance is a critical component. The protection of insurance as a component of an overall risk management portfolio is essential in the economic recovery of communities following disasters. Risk control and risk financing are both critical to this portfolio in managing risk. Risk control being the mitigation measures of avoidance, loss prevention, and loss reduction and risk financing includes retention, noninsurance transfer of risk, and insurance. FEMA's Insurance policy, to be successful, needs to support both risk control and risk financing.

As a component of risk financing, an added layer of protection is afforded to public jurisdictions through the Robert T. Stafford Disaster Relief and Emergency Assistance Act.<sup>1</sup> Assistance under the Act is authorized after the President determines that an event is of the severity and magnitude to warrant a presidential major disaster or emergency declaration to support response, recovery, and mitigation efforts.<sup>2</sup> The Act proclaims that disasters often disrupt the normal functioning of governments and communities and those special measures for reconstruction and rehabilitation of devastated areas are necessary to assist the efforts of the affected states and tribes in expediting the rendering of aid, assistance, and emergency services.<sup>3</sup> While the Stafford Act authorizes assistance to both individuals and public jurisdictions, the area of research of this work is focused on the buildings and other insurable facilities that would receive assistance through FEMA's Public Assistance program.

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<sup>1</sup> Federal Emergency Management Agency, *Public Assistance Policy Digest* (Washington, DC: FEMA P-321, 2008), 41.

<sup>2</sup> *Ibid.*, 124.

<sup>3</sup> Robert T. Stafford, Disaster Relief and Emergency Assistance (The Stafford Act) Act, as amended, and Related Authorities, Public Law 93-288, codified at United States Code 42 (2013), § 5121 et seq (Section 101(a)(2)).

The Stafford Act provides adequate guidance on insurance and the intent of Congress on the role of insurance in FEMA's Public Assistance program. The guidance provided in the 44 CFR has not kept up with the industry since being drafted as an interim rule in 1991. The insurance section in the 44 CFR is dated and provides ambiguous guidance on insurance regulation. The Public Assistance Guide, Public Assistance Digest, and the Disaster Assistance Policy on "Insurance Responsibilities for Field Personnel" address existing FEMA policy on insurance considerations. FEMA policy has changed with the recent rescission of the fact sheet titled "Insurance Considerations for Applicants." The rescinded fact sheet provided the only policy level guidance on the eligibility of deductibles in a subsequent event. While the FEMA policy is under review, the rescission leaves the current guidance provided in imprecise regulations, open to interpretation on the eligibility of deductibles in a subsequent event.

FEMA's Public Assistance Program as related to insurance should be shaped to promote resiliency and sound practices of risk management in order to reduce the reliance on federal support following a major disaster. The program should be shaped in order to provide incentives and disincentives for insurance coverage that do not create a moral hazard in decision making to applicants or in the federal policy that promotes poor risk management. Communities should have an incentive to recover faster from the first event in order to increase community resilience. And, the taxpayer's investment in assistance provided for a damaged facility must be protected in a subsequent event.

The Stafford Act addresses six important provisions as related to insurance. These provisions must shape policies related to insurance in the Public Assistance Program.

- The intent of Congress with respect to insurance as defined in the Stafford Act is to encourage individuals and governments to protect themselves by obtaining insurance to supplement or replace government assistance;<sup>4</sup>
- The intent of Congress is to encourage hazard mitigation to reduce losses from disasters;<sup>5</sup>
- A requirement to obtain and maintain insurance as a condition of receiving PA grant funding;<sup>6</sup>
- A prohibition on duplication of disaster assistance benefits (from any source, including insurance proceeds);<sup>7</sup>
- Deductions from grant funding for certain uninsured facilities located in an SFHA;<sup>8</sup> and
- FEMA shall not require greater types and extent of insurance than are certified to him as reasonable by the appropriate State Insurance Commissioner responsible for such insurance.<sup>9</sup>

These six key provisions must shape the insurance policy in order to comply with the intent of Congress and the adherence to law as related to insurance. The four pillars that support these provisions are the requirement of insurance, types of insurance policies, eligibility of insurance deductibles, and promote resiliency and mitigation of future damages.

Currently, the only requirement of insurance is in the form of obtain and maintain requirements from eligible damage in a presidentially declared disaster. As a result of a Public Assistance grant, the facility owner is required to obtain and then maintain insurance as a condition of that grant. Otherwise, facility owners are not required to have insurance prior to receiving federal assistance with exception of facilities located in a Special Flood Hazard Area for greater than one year.

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<sup>4</sup> The Stafford Act, Section 101.

<sup>5</sup> Ibid.

<sup>6</sup> Ibid., Section 311(b).

<sup>7</sup> Ibid., Section 312.

<sup>8</sup> Ibid., Section 406(d).

<sup>9</sup> Ibid., Section 311(a)(2).

For flood, insurance requirements can be satisfied through three options. One, insurance policies purchased through the National Flood Insurance Program. Two, policies purchased through the Write-Your-Own program, which follow all terms and conditions of a Standard Flood Insurance Policy. Three, facility owners may elect to self-insure, which may include some commercially purchased insurance as a component of that coverage. The election to self-insure requires review and approval of the plan.

For other than flood, insurance requirements can be met through specific policies covering a single facility, self-insurance, blanket insurance policies covering multiple facilities, or an insurance pool arrangement. Blanket policies are defined in insurance law. However, insurance pool arrangement is not defined but is currently considered as all risk pools. The intent of current regulation provides an option for facility owners to reduce the cost of insurance and allows options in an efficient insurance arrangement from a risk management viewpoint. Conversely, the option to pool all facilities may not fully cover the previous deductible of the damaged facility; therefore, the regulation offers the facility owner options while protecting the taxpayer in the eligibility of previous disaster assistance.

Comparing the actions of other countries can be insightful in looking at our own methodology. The programs being implemented in Australia and Canada offer several significant differences. Australia makes adjustments for uninsured facilities based on the approval an insurance assessment. Canada makes adjustments based on what was reasonably available.

The recommended course of action in establishing a requirement of insurance for all public facilities is a layered approach in order to encourage facility owners to protect themselves by obtaining insurance to supplement or replace government assistance. The requirement of insurance would be defined through a multiple step review. First, does the facility owner have an insurance policy or a plan? As previously addressed, the decision to self-insure or have no insurance is a decision to retain the risk of loss to the insurable facility. Second,

does the state or local jurisdiction have a minimum insurance level? The minimum insurance requirement would be defined in the hazard mitigation plan of the state or local jurisdiction. Third, if the insurable facility owner did not have an insurance plan or the applicable Hazard Mitigation Plan did not establish a minimum insurance level, an independent review panel would be convened by the Regional Administrator to establish the minimum amount of insurance that was reasonably available to the insurable facility owner. This review would be established by the Regional Administrator in determining the insurance that would have been reasonably available based on historical project level data. In addition, the federal share would be reduced to 25% in a subsequent event due to damages from the same type of event within a 10 year period without the appropriate mitigation measures taken as a disincentive for the lack of any risk management.

Facility owners have many decisions to make regarding the types of insurance policies in order to protect their facilities from a loss. For states, the most basic decision is to whether to purchase insurance, elect to self-insure and retain the risk of loss themselves, or pursue other risk transfer measures.

Self-insurance or a self-insured retention incorporates decision-making to retain risk. While the types of self-insurance may be cost effective, the insured has the responsibility for the retained risk, which may be all or part of the facility value.

The election to self-insure requires notification to the president, which is delegated to FEMA, for review and approval of a self-insurance plan. The Federal Insurance Administrator has the final review and approval of the self-insurance plan for flood hazards, as addressed in the 44 CFR. For other than flood hazards, the state must either declare its election to self-insure in writing at

the time of acceptance of assistance, or subsequently, and submit an established plan of self-insurance with supporting documentation for approval to FEMA's Assistant Administrator for Recovery.<sup>10</sup>

FEMA should not be concerned as to the type of insurance policy (self-insurance, blanket, scheduled, pooled, or other arrangement). In turn, the facility owner should not be limited in purchasing the types of insurance that best fit the facility owner's risk management requirements. The type of policy is a risk management decision and should be left to the facility owners. FEMA should be only concerned that a facility is protected by insurance or insurance like product in the first event when reasonably available and the federal investment is protected, when grant funding was provided to facility owner, in the subsequent event. The applicant should have the flexibility to manage their own risk in determining insurance requirements without undue burden to the taxpayer. The ability of the applicant to select the type of policy that best fits their needs, which includes self-insurance for all jurisdictions that have the capacity to appropriately manage such an insurance portfolio.

The facility owner's decision on deductibles is a key component of managing risk in order to protect facilities from an unexpected loss. Deductible decisions are a component of risk retention by a facility owner, as opposed to transferring risk to another party. Balancing retained risk and the insurance premium is part of the decision process in the overall risk financing of a facility, which includes the deductible and the protection of insurance.

FEMA's Public Assistance program currently reimburses applicants for a reasonable deductible from the first event and, in some cases, subsequent events. However, defining reasonable is not delineated and, in the complex world of risk management, reasonable may be becoming more difficult to characterize with the multitude of retained risk and self-insurance options.

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<sup>10</sup> The Stafford Act, Section 311(c).



Again, comparing the actions of other countries, Australia and Canada do not reimburse for deductibles in a first or subsequent event.

The Stafford Act is silent on deductibles. The Act does provide the insurance commissioner great authority as the “the President shall not require greater types and extent of insurance than are certified to him as reasonable by the appropriate State insurance commissioner responsible for regulation of such insurance.”<sup>11</sup> FEMA’s February 8 memo rescinded Disaster Assistance Fact Sheet 9580.3.<sup>12</sup> While the memo addressed and re-stated several issues involving insurance, the memo has left many questions related to insurance deductibles. The memo permits the reimbursement of second deductibles for all policies except blanket insurance policies.

Deductible decisions are a component of risk retention by a facility owner. The balance between retained risk and insurance premium is part of the overall risk financing of a facility, which include the deductible and insurance. In addition, the reimbursement of a deductible from a second or subsequent event may be considered a duplication of benefits.

The proposed regulation in this document would not require greater types and extent than deemed appropriate and reasonable by the State Insurance Commissioner. Each facility owner will still be able to retain all the risk or as little of the risk they choose to retain. However, this proposed regulation would make deductibles ineligible for assistance.

Resiliency and hazard mitigation are critical in reducing the costs of future disasters and building communities that are more resilient. Federal encouragement can enhance resiliency and stress the importance of resiliency to local communities. Local based recovery approaches are most effective to the

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<sup>11</sup> The Stafford Act, Section 311.

<sup>12</sup> Deborah Ingram, “Disaster Assistance Fact Sheet 9580.3, Insurance Considerations for Applicants,” Letter of February 8, 2013.

long term sustainability of communities.<sup>13</sup> Federal and state resources must assist communities incorporate resiliency and sustainability goals into their post disaster recovery planning both in technical assistance and in financial incentives. The Stafford Act provides a federal share of assistance for both 404 and 406 mitigation measures. The Act also provides the disincentive for facilities where mitigation measures were not taken and the facility sustains a repetitive loss within a 10-year period.

Disasters happen—the risks cannot be completely eliminated.<sup>14</sup> The risks can be reduced through a more complete understanding of the value and importance of mitigation and resiliency. With the right financial incentives and disincentives for hazard mitigation, communities can be more resilient and better prepared to withstand an event and recover faster, stronger, and more cost effective.

In addition, resiliency and hazard mitigation are the intent of Congress as delineated in the Stafford Act. However, current regulations need to codify the incentives for hazard mitigation, which will lead to improved resiliency. This can be accomplished in current law but the regulation does not exist. The Stafford Act provides for a reduced federal share for facilities damaged on more than one occasion within a proceeding ten-year period by the same type of event and the owner of a facility has failed to implement appropriate mitigation measures to address the hazard that caused the damage to the facility.<sup>15</sup> The Act allows for the reduction of assistance to not less than 25 percent. Providing an incentive to facility owners to mitigate damages following a first event, the facility and the taxpayer are better protected in a subsequent event and would increase the resiliency of the facility and the community in subsequent events.

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<sup>13</sup> Dennis Mileti, *Disasters by Design: A Reassessment of Natural Hazards in the United States* (Washington, D.C.: Joseph Henry Press, 1999), 240.

<sup>14</sup> Federal Emergency Management Agency, *FEMA Mitigation and Insurance Strategic Plan 2012–2014* (Washington, D.C.: FEMA P-857, 2011), 31.

<sup>15</sup> The Stafford Act, Section 406(b)(2).

The use of mitigation would greatly increase resiliency in communities. The benefit to the facility owner and the taxpayer is substantial as the vulnerability of a community is reduced in a subsequent event. Providing an incentive to facility owners to mitigate in the first event, the facility and the taxpayer are protected in a subsequent event. While the Stafford Act permits a 25% federal share, the federal share should be stepped down over subsequent events when facility owner fails to perform mitigate measures. For example, the first event the federal share would be the normal 75% federal share (or 90% federal share in more catastrophic events consistent with current policy).<sup>16</sup> The second event would be no more than a 50% federal share for damages to the same facility for the same type of peril. The third event the federal share would be 25% federal share. The exception would be for facilities that do not have insurance or an insurance protection plan where the facility would only be eligible for 25% federal share in a second or subsequent event. Although the incentive is negative, reduced federal assistance in future events is a significant incentive to facility owners to mitigate damages in the first event and encourages facility owners protect themselves with insurance.

In conclusion, FEMA's insurance policy for the Public Assistance Program should consider affordability, adequate insurance, fairness, while promoting flexibility to the applicant and risk management decisions that are not based on the moral hazard of insurance or federal policy. The revision of regulation and policy will correct these deficiencies and create overall guidance that promotes effective management for the facility owner and the taxpayer.

Insurance and the policy related insurance in FEMA's Public Assistance program is out dated and needs to be revised. The Stafford Act can support most of the recommended changes presented in this research. The only change is that the ability to self-insure should be expanded to include states, tribes, local governments, and select non-profit organizations. This change would allow all

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<sup>16</sup> The cost share adjustment to 90% federal share is \$133 per capita (FY13) of federal assistance provided to a given tribe electing to be a grantee or state.

eligible applicants the ability to manage their own risk and create cost effective solutions in managing that risk. The 1991 interim rule on insurance can be greatly enhanced to allow for better risk control and risk financing. The four pillars of insurance include the requirement of insurance, freedom to choose the types of insurance policies that best fit the facility owner, ineligibility of deductibles, and incentives for mitigation will greatly improve the existing insurance policy.

The Department of Homeland Security–Office of Inspector General (DHS-OIG) agrees and has expressed their viewpoint in the defining insurance policies and insurance requirements through their December 2011 report on insurance regulation. The report recommends that FEMA continue with proposed insurance requirement started in 2000 and explain whether local government or PNP organizations could qualify as a self-insurer for purposes of meeting the insurance purchase requirements. The report recommends that the rulemaking process begun in 2000 continue and that FEMA prepare and issue additional guidance for self-insurance, among other topics.<sup>17</sup> This is important in defining the type of policies available to public organizations that own state, local, tribal, or private non-profit facilities.

The net effect of these changes will encourage facilities owners to retain the appropriate risk in deductibles and self-insurance as federal assistance would not be available for these components of risk financing. The most likely scenario of the effect will be facility owners retaining less risk with lower deductibles for their facilities. While the limit of liability of insurance policies across the country may change, insurance requirement and risk management profiles defined in state and local hazard mitigation plans will assist in defining the risk that the federal government faces as the provider of last resort. The net effect could be a lower limit of liability as facility owners assess the appropriate risk profile. Most importantly, the risk profile and overall risk management of their facilities will be

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<sup>17</sup> Michael D. Beard, Department of Homeland Security–Office of Inspector General, “FEMA’s Process for Tracking Public Assistance Insurance Requirements” (2011), 13–14.

based on their assessment of that risk, not federal policy. By defining the risk above an insurance limit of liability in a transparent manner, we as a nation can begin to explore alternate measures to expand our risk bearing capacity to support state and local communities in a catastrophic event. This evaluation of risk can occur before a catastrophic event, not after it has occurred.

In a holistic viewpoint on risk, the end state of public policy on insurance needs to expand beyond the updating and revisions of public policy insurance. Planning for a catastrophic event needs to be part of that solution. As stated, the starting point is understanding the risk faced by the federal government and taxpayer. Today, this risk is undefined. In a catastrophic event, the federal government must provide assistance for an undetermined and uncapped amount of risk. By including an insurance requirement through the state and local hazard mitigation plans, we can begin the voluminous task of defining that risk, analyzing the exposure to the federal government and the taxpayer, and mitigating the risk through the partnerships of the private sector, local governments, state governments, and the federal government. By mitigating the risk to facilities across the country, we can begin to reduce the costs of disaster assistance. Law, regulation, and policy must be supportive of innovative solutions in support of responsible risk management in all our communities.

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## **ACKNOWLEDGMENTS**

The guidance and counsel of Director Glen Woodbury and Dr. Nadav Morag are greatly appreciated. I am indebted for their assistance and encouragement in discussing the many subjects related to insurance, mitigation, disaster assistance, and resiliency. Without their steadfast advice this research would not have been possible. I would also like to thank Dr. Christopher Bellavita and the entire Center for Homeland Defense and Security (CHDS) staff. Collectively, their efforts in the operations and curriculum of the CHDS Masters' Degree program including the many discussions, both inside and outside of the classroom, were significant and essential in the education and crafting of this thesis.

The patience and understanding of my wife and family contributed greatly to the last two years in completing the curriculum and the research effort that was put forward in this work. As always, their love helped endure the effort required and time commitment of the program.

I have a deep appreciation of my friends and colleagues that took the time to read the various drafts of the following chapters, provide input, and took phone calls at all hours of the day to discuss the topic at hand. Thank you.

Finally, I have the hope that the research put forth in this effort will contribute to improving the Public Assistance program, and contribute to better risk management and a heightened understanding of the risks and vulnerabilities of communities across the nation. Only in the understanding these risks and vulnerabilities can we take steps to make improvements, reduce the costs of disasters, and enhance the resiliency of the nation.

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## I. INTRODUCTION

Insurance is a complex industry, which is a large component of the U.S. economy. In 2012, insurance premiums in the life and health and property and casualty insurance sectors totaled more than \$1.1 trillion, or approximately 7% of gross domestic product.<sup>1</sup> The insurance industry provides complex alternatives in the protection of insured facilities throughout the nation from a loss, including from vulnerabilities from natural disasters.

Of the ten costliest disasters in U.S. history, eight were damages caused by hurricanes, of which six made landfall since 2000 according to the National Association of Insurance Commissioners. Hurricane Katrina in 2005 caused \$125 billion of overall losses with insured losses of \$62 billion, which remains the worst disaster in U.S. history.<sup>2</sup> Hurricane Sandy in 2012 and the 1994 Northridge Earthquake are the second and third worst disasters in U.S. history with \$20 billion and \$15 billion in insured losses, respectively.

Disaster losses from natural disasters have a tremendous financial impact on the US economy, insurance companies, and the taxpayer. Despite relatively few significant events in the first half of 2013, insured losses worldwide reached \$20 billion, as compared to the 10-year average of \$25 billion for the six-month period.<sup>3</sup> Roughly, half of the losses for the period were in the United States, which included severe weather in March 2013, severe weather and tornadoes in May 2013, and a winter storm in April 2013. In 2012, U.S. insured losses totaled

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<sup>1</sup> U.S. Department of the Treasury, *Annual Report on the Insurance Industry* (Washington, D.C.: Federal Insurance Office, 2013), 5.

<sup>2</sup> NatCatService, "Significant Natural Catastrophes 1980–2012," last modified March 2013, accessed October 2, 2013, [http://www.munichre.com/app\\_pages/www/@res/pdf/NatCatService/significant\\_natural\\_catastrophes/2012/NatCatSERVICE\\_significant\\_eco\\_en.pdf](http://www.munichre.com/app_pages/www/@res/pdf/NatCatService/significant_natural_catastrophes/2012/NatCatSERVICE_significant_eco_en.pdf).

<sup>3</sup> Impact Forecasting/Aon Benfield, "1st Half 2013 Natural Disasters Cost \$85 Billion," *Insurance Journal*, July 25, 2013.

\$58 billion for weather related catastrophes, which far exceeded the 10-year average of \$27 billion per year in the United States according to the National Association of Insurance Commissioners.

As these insured losses indicate, insurance plays a critical role in the economic recovery of communities following catastrophic events. For most entities, insurance is the only method of managing risk in event of a loss. In some cases, insurance protection from catastrophic damage could be the difference between recovery and the inability to do so. For public jurisdictions, an added layer of protection is afforded to state governments, tribal governments, local governments, certain private nonprofits, and other essential governmental services through the Robert T. Stafford Disaster Relief and Emergency Assistance Act.<sup>4</sup> Assistance under this Act is authorized after the President determines that an event is of the severity and magnitude to warrant a major disaster or emergency declaration to support response, recovery, and mitigation of the state or tribe.<sup>5</sup> The Act proclaims that disasters often disrupt the normal functioning of governments and communities and those special measures for reconstruction and rehabilitation of devastated areas are necessary to assist the efforts of the affected states and tribes in expediting the rendering of aid, assistance, and emergency services.<sup>6</sup> While the Stafford Act authorizes assistance to both individuals and public jurisdictions, the area of research of this work is focused on the buildings and other insurable facilities that would receive assistance under FEMA's Public Assistance program and shortcomings in the law, regulation, and policy associated with the current guidance on insurance considerations.

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<sup>4</sup> Federal Emergency Management Agency, *Public Assistance Policy Digest* (Washington, DC: FEMA P-321, 2008), 41.

<sup>5</sup> *Ibid.*, 124.

<sup>6</sup> Robert T. Stafford, Disaster Relief and Emergency Assistance Act (The Stafford Act), as amended, and Related Authorities, Public Law 93-288, codified at United States Code 42 (2013), § 5121 et seq (Section 101(a)(2)).

Public Assistance is the largest component of disaster assistance programs provided by FEMA. Between 2000 and 2012, over \$46 billion of assistance has been provided through FEMA's Public Assistance program or an average of \$3.5 billion per year according to the Federal Emergency Management Agency website. Hurricane Katrina represents a substantial portion of the total assistance provided, as the largest disaster in US history. Excluding Public Assistance damages from Hurricane Katrina, Public Assistance program provided an average of \$2.7 billion per year between 2000 and 2012.

In providing such relief, FEMA's Public Assistance program provides assistance for emergency work—debris removal and emergency protective measures—and permanent work. In addressing permanent work, one of the five categories of assistance is for buildings and equipment.<sup>7</sup> Facilities eligible for assistance in the category E (Buildings and Equipment) component of permanent work are typically insurable and that is the primary focus of this research. Although, insurance is applicable to all categories of work, including debris removal, temporary facilities, and the other categories of permanent work.

The key components of insurance as related to FEMA's Public Assistance program are the prohibition of a duplication of benefits, deductions from grant funding for uninsured facilities in a Special Flood Hazard Area (SFHA), and the requirement to obtain and maintain insurance after a facility sustained damage, which was the result of a declared event. After a presidentially declared disaster, the role of insurance through FEMA's Public Assistance program can be a contentious issue. While insurance from the first disaster is not as controversial, the implications from the first disaster have significant impacts on a subsequent, similar event. In the first event, the insurance obtain and maintain requirements are established as condition of the grant. The obtain and maintain requirement dictates insurance coverage for a facility on subsequent events of the same type.

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<sup>7</sup> Federal Emergency Management Agency, Public Assistance Policy Digest, 17.

The requirement to obtain and maintain insurance as a condition of the grant represents the protection of the federal investment in the damaged facility.

In FEMA's Public Assistance program, the law and regulation are provided by the Robert T. Stafford Disaster Relief and Emergency Assistance Act, as amended, and related authorities and Title 44 of the Code of Federal Regulations, respectively. The policy of insurance and guidance in the administration of insurance as related to FEMA's Public Assistance program is provided by various FEMA documents including the Public Assistance Guide and Public Assistance Digest. The law is the overarching guidance supported by regulation and then policy.

There are six key provisions in the Stafford Act that relate to insurance and the Public Assistance program:

- The intent of Congress with respect to insurance as defined in the Stafford Act is to encourage individuals and governments to protect themselves by obtaining insurance to supplement or replace government assistance;<sup>8</sup>
- The intent of Congress is to encourage hazard mitigation to reduce losses from disasters;<sup>9</sup>
- A requirement to obtain and maintain insurance as a condition of receiving PA grant funding;<sup>10</sup>
- A prohibition on duplication of disaster assistance benefits (from any source, including insurance proceeds);<sup>11</sup>
- Deductions from grant funding for certain uninsured facilities located in an SFHA;<sup>12</sup> and
- FEMA shall not require greater types and extent of insurance than are certified to him as reasonable by the appropriate State Insurance Commissioner responsible for such insurance.<sup>13</sup>

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<sup>8</sup> The Stafford Act, Section 101.

<sup>9</sup> Ibid.

<sup>10</sup> Ibid., Section 311(b).

<sup>11</sup> Ibid., Section 312.

<sup>12</sup> Ibid., Section 406(d).

<sup>13</sup> Ibid., Section 311(a)(2).

These provisions are the key to most insurance related issues and the administration and implementation of the Public Assistance program as related to insurance. Based on these provisions, FEMA's Public Assistance program should be shaped to better promote sound risk management, improve community resiliency, and enhance efficient insurance coverage decision making for facility owners that is equitable, effective, and efficient insurance protections for the facility owner, the state, the taxpayer and FEMA.

## **A. INSURANCE OVERVIEW**

The intent of Congress is that the federal government continues to provide assistance to state and local government in carrying out their responsibilities to alleviate suffering and damage, which result from disasters.<sup>14</sup> Moreover, the intent of Congress is that state, tribal, and local governments protect themselves by obtaining and maintaining coverage to supplement or replace government assistance.<sup>15</sup> Additionally, Congress provides the intent of encouraging hazard mitigation measures to reduce losses from disasters including development of land use and construction regulations.<sup>16</sup> The Sandy Recovery Improvement Act of 2013 further reiterated the intent of Congress by requiring the Administrator of the Federal Emergency Management Agency submit to Congress recommendations for the development of a national strategy for reducing future costs, loss of life, and injuries associated with extreme disaster events in vulnerable areas of the United States.<sup>17</sup> The national strategy is due 180 days from the enactment of the law.

The core of the guidance on insurance in FEMA's Public Assistance program is available through existing law, regulation, and policy. The Robert T Stafford Act provides the law. Sections 311, 312, and 406 provide the direction

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<sup>14</sup> The Stafford Act, Section 101(b).

<sup>15</sup> Ibid., Section 101(b)(4).

<sup>16</sup> Ibid., Section 101(b)(5).

<sup>17</sup> Sandy Recovery Improvement Act of 2013, Public Law 113–2, Congressional Record Volume 158 (2013), Section 1111(a).

and guidance. Section 311 provides congressional guidance on insurance.<sup>18</sup> Section 312 provides guidance on the duplication of benefits.<sup>19</sup> Section 406 provides guidance on the repair, restoration, and replacement of damaged facilities including insurance considerations on those facilities.<sup>20</sup> Title 44 of the Code of Federal Regulations (44 CFR) provides the more refined guidance for implementation of the law and regulation of insurance under the Public Assistance program. These regulation is provided by 44 CFR § 206.252 and § 206.253 on insurance for flood and other than flood events, respectively.<sup>21</sup> Lastly, the Public Assistance Digest, Public Assistance Guide, and Disaster Assistance Policy 9580.3 provide the Federal Emergency Management Agency policy on the insurance.<sup>22</sup> A May 2008 fact sheet was rescinded on February 8, 2013, which provided additional policy guidance related to insurance.<sup>23</sup> While the FEMA policy is under review, the recession of the Disaster Assistance Policy leaves imprecise regulations, which are open to interpretation on the eligibility of deductibles in a subsequent event, as the sole guidance in the implementation of insurance eligibility determinations.

Resolving the role of insurance as related to FEMA's Public Assistance Program could have tremendous impact in affecting recovery for state and local governments. The critical component and core issue on insurance in FEMA's Public Assistance program is ensuring state, tribal, and local governments are protected from damages today and more resilient to disasters tomorrow. The

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<sup>18</sup> The Stafford Act, Section 311.

<sup>19</sup> Ibid., Section 312.

<sup>20</sup> Ibid., Section 406.

<sup>21</sup> Code of Federal Regulations, Title 44, § 206.252 and § 206.253.

<sup>22</sup> Federal Emergency Management Agency, Disaster Assistance Policy 9580.3, "Insurance Considerations for Applicants," May 2008.

<sup>23</sup> Deborah Ingram, "Disaster Assistance Fact Sheet 9580.3, "Insurance Considerations for Applicants," Letter of February 8, 2013.

insurance implementation and recommendations addressed in this document attempt to align those principles and the intent of Congress as delineated in the Stafford Act.

## **1. A Brief History of Insurance in the United States**

States regulate insurance in the United States.<sup>24</sup> Each state has an Insurance Commissioner that has been appointed by Governor or has been elected depending on the state. The power of this position has been upheld through the court systems at the federal and state level.

The roots of the insurance industry in the United States were formed when Benjamin Franklin helped in the creation of the “Philadelphia Contributionship for the Insurance of Houses from Loss by Fire” in 1752.<sup>25</sup> One hundred years later, New Hampshire appointed the first insurance commissioner in 1851 as states needed to supervise the growing insurance industry.

The marked history and conflict between the federal and state governments exploded in 1868. During the period, several state legislatures created independent administrative agencies to supervise insurance within their borders. As the insurance industry expanded, insurance companies sought federal regulation in exempting to avoid burdensome multiple state regulation. Insurance companies preferred what they presumed would be weak federal regulation to sometimes aggressive state oversight as their operations extended across states lines.<sup>26</sup> Several New York-based insurance companies hired Samuel Paul, a Virginia resident, to represent them as their agent in Virginia but refused to deposit the licensing bond required by Virginia statute. Paul was consequently denied a license to sell insurance in the insurance companies’

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<sup>24</sup> Susan Randall, Insurance Regulation In the United States: Regulatory Federalism and the national Association of Insurance Commissioners, Florida State University Law Review, Volume 26:625, 626.

<sup>25</sup> The Center for Insurance Policy and Research, “State Insurance Regulation,” National Association of Insurance Commissioners (2011), 2.

<sup>26</sup> Randall, Insurance Regulation in the United States, 629.

effort to supplant state authority. The Supreme Court held, in the case *Paul v. Virginia*, which “issuing a policy of insurance is not a transaction of commerce” and Samuel Paul would have to adhere to Virginia law in order to represent the New York insurance companies.<sup>27</sup> As a result, states maintained the responsibility over the taxation and regulation of insurance.

In 1871, the state insurance regulators formed the National Insurance Convention to discuss issues of “common concern,” which later became known as the National Association of Insurance Commissioners (NAIC). The New York superintendent of insurance asked the insurance commissioners across all thirty-six states to attend a meeting to discuss insurance regulation. Representatives of nineteen states attended, marking the beginning of what was then known as the National Insurance Convention.<sup>28</sup> At the second meeting later that same year, all thirty six insurance regulators attended. As the industry evolved, so has the NAIC. Currently, insurance commissioners from all 50 states, the District of Columbia, and US territories participate in the organization.

In the late 1800s, several states were engaged in establishing legislation in order to better control insurance rates and fixing of insurance rates. The State of Missouri was one of the first to amend anti-trust laws to include insurance companies in 1895 in order to better ensure fair competition amongst the insurance companies.<sup>29</sup>

In 1909, the State of Kansas was early in establishing regulation to give the insurance commissioner authority in the determination of “adequate but not excessive” insurance rates.<sup>30</sup> Litigation, *German Alliance Insurance Company v. Lewis*, arising out of the Act was upheld in US Supreme Court that insurance was

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<sup>27</sup> Randall, *Insurance Regulation in the United States*, 631.

<sup>28</sup> *Ibid.*, 632.

<sup>29</sup> Spencer L. Kimball and Ronald N. Boyce, “The Adequacy of State Insurance Rate Regulation: The McCarran-Ferguson Act in Historical Perspective,” *Michigan Law Review*, Volume 56 (1958), 549.

<sup>30</sup> Kimball and Boyce, “The Adequacy of State Insurance Rate Regulation,” 551.



affected with a sufficient public interest for the state to control its price.<sup>31</sup> By 1944, all but three states had some control of insurance rate making, either with rate regulation or anti-trust provisions.<sup>32</sup>

As the development in the struggle in the state regulation of insurance evolved, the Supreme Court, in *United States v. Southeastern Underwriters Association*, ruled to overturn the *Paul v. Virginia* decision in 1944. In the *Southeastern Underwriters Association* case, the United States Supreme Court held that insurance was indeed commerce and subject to federal regulation under the Commerce Clause.<sup>33</sup> This decision caused turmoil in the industry as the ruling resulted in a regulatory void in the states regulation insurance.

After the *Southeastern Underwriters Association* decision, NAIC proposed through Senators McCarran and Ferguson insurance regulation which was the foundation of the legislation that eventually became law. The McCarran-Ferguson Act passed and was signed into law in March of 1945 to fill the regulatory gap in supporting the state regulation of insurance.<sup>34</sup> Interestingly, two bills preceded the McCarran-Ferguson Act, which were supported by the fire insurance companies. Both of these bills stalled in September of 1944 with introduction of the NAIC proposal.<sup>35</sup> The McCarran-Ferguson Act declared that the continued regulation and taxation by the states of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the states.<sup>36</sup>

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31 *Ibid.*, 551.

32 *Ibid.*, 552.

33 *Insurance Regulation in the United States*, 633.

34 NAIC, *State Insurance Regulation*, 2.

35 Robert Guenter, "Rediscovering the McCarran-Ferguson Act's Commerce Clause Limitation," 6 *Conn. Insurance Law Journal*, Volume 253, 1999–2000, 293.

36 The McCarran-Ferguson Act of 1945, codified as 15 U.S.C. §§ 1011–1015, Section § 1011.

Today, the regulation of insurance remains under the interest of the states, District of Columbia, and US territories. In addition, the NAIC is an active organization comprised of all the State Insurance Commissioners.

## **2. Literature Review**

The preponderance of literature available on the treatment of insurance under FEMA's Public Assistance program is in law, regulation, and policy. The Stafford Act, 44 CFR, and FEMA Policy form the basis for the subject area of analyzing the policy and challenges of FEMA's current considerations on insurance in Public Assistance. While the history of the insurance industry is important to the foundation of policy, the critical point is the development of the importance of the State Insurance Commission's role in history and within insurance regulation in the state. The documentation of history provides a clear understanding of the importance in law and regulation of the key state regulators role in the business of insurance.

The Stafford Act provides the statutory authority by which the federal government provides disaster and emergency assistance to support communities in recovery. Under the Stafford Act, FEMA coordinates the federal government's response, working to support and supplement the efforts and capabilities of state, tribal, and local governments, eligible nonprofit organizations, and individuals affected by an event of the severity and magnitude to be declared by the president as a major disaster or emergency.<sup>37</sup>

The laws, regulations, and policy are clearly documented in their existing forms. The original source documentation is the key to formulation of exploring the role of insurance within FEMA's Public Assistance program.

The Department of Homeland Security, Office of Inspector General (DHS-OIG) documented problems with the compliance of insurance law and regulation

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<sup>37</sup> Federal Emergency Management Agency, *FEMA Publication 1* (Washington, D.C.: FEMA, 2010), 35.

in the Public Assistance program in December 2011. The concerns presented in DHS-OIG report document key issues that are core to the research on insurance as related to FEMA's Public Assistance program.<sup>38</sup>

Publications, analysis, and documentation are plentiful on the insurance industry. However, this preponderance of literature will provide limited value to this research as previously addressed. Similarly, documentation on the National Flood Insurance Program (NFIP) is abundant. However, this literature will be limited in usefulness as the inter-workings of NFIP policies are not directly applicable to insurance proceeds, deductibles and requirements to "obtain and maintain" insurance under the Public Assistance program. Additionally, the NFIP addresses only flood related disasters and flood insurance law and regulation. Appropriately, these policies do not address the law and regulation of assistance for "other than flood" disaster related damages. Conversely, the literature on the NFIP, which is directly related to the implementation and administration of Public Assistance, will be important to this research, especially in the area of insurance options for public jurisdictions and insurance requirements in the a first or subsequent event.

## **B. PROBLEM STATEMENT**

Generally, eligible uninsured losses in FEMA's Public Assistance Program include the following items:<sup>39</sup>

- Reasonable deductible in the applicant's first claimed FEMA assistance if the cost is accrued to the applicant.
- Depreciation; (i.e., differences in FEMA eligible costs and final loss valuations used by insurers); and
- Costs in excess of an insurance policy limits, including sub-limits for certain hazards (such as flood or earthquake)

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<sup>38</sup> Michael D. Beard, Department of Homeland Security—Office of Inspector General, "FEMA's Process for tracking Public Assistance Insurance Requirements," OIG-12-18 (December 2011).

<sup>39</sup> Federal Emergency Management Agency, *Public Assistance Guide* (Washington, D.C.: FEMA 322, June 2007), 122.

The existing law, regulation, and policy on insurance provide direction and guidance to FEMA, the state, tribes, and the local jurisdictions. However, these source documents are not clear in their direction and guidance. They do not promote sound risk management and efficient insurance coverage decision-making in order to promote fair and equitable burden for the applicant, the state, tribes, FEMA, and the taxpayer.

The Robert T. Stafford Relief and Emergency Assistance Act provides appropriate guidance on the statutory treatment of insurance in the reimbursement of damages as a result of a presidentially declared disaster. Several statutory components in the law are critical to the importance of insurance and Congress's intent on insurance coverage and requirements.

The law requires insurance for assistance provided in a previous event to protect against future loss to such property.<sup>40</sup> This obtain and maintain requirement ensures that the federal investment in a previous event is protected in subsequent, similar events.

The law recognizes the authority of the State Insurance Commissioner as the regulator of insurance and the law protects the authority of the role of the commissioner. This acknowledgement in law ensures insurance greater than types and extent of insurance that are certified by the insurance commissioner shall not be required.<sup>41</sup> The provision protects the importance of the State's Insurance Commissioner as the regulator authority for insurance. The law provides guidance to ensure that a state may act as a self-insurer and solidifies the state's ability to make such an election. The law also restricts federal assistance to personal, residential, or commercial property if flood insurance was not obtained and maintained.<sup>42</sup>

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<sup>40</sup> The Stafford Act, Section 311(a)(1).

<sup>41</sup> Ibid., Section 311(a)(2).

<sup>42</sup> Ibid., Section 311a (a).

The 44 Code of Federal Regulations is not as clear in guidance on the treatment of insurance. The regulation provides guidance on insurance for facilities damaged by flood and other than flood. For facilities damaged by flood, the guidance is clear on facilities in a Special Flood Hazard Area. A reduction of assistance will be the maximum amount of insurance proceeds available in a standard flood insurance policy.<sup>43</sup> This reduction is the eligible disaster damage related costs minus insurance proceeds or mandatory reduction if the facility is not insured.

For facilities damaged by other than flood, the regulation is not as clear. The regulation requires an insurance reduction for eligible costs by the actual amount of insurance proceeds, provides guidance on the obtain and maintain requirements for previous damages, affords the Insurance Commissioner the appropriate authority under the law, and provides guidance on the blanket insurance policies or insurance pool arrangement.<sup>44</sup> There is no requirement of insurance in current guidance.

FEMA provides policy guidance through the Public Assistance Digest, Public Assistance Guide, and a FEMA Disaster Assistance Policy on “Insurance Considerations for Field Staff.” In February 2013, FEMA rescinded Disaster Assistance Policy 9580.3, which provided answers for “Insurance Considerations for Applicants.” This policy provided clarification for insurance deductibles. The policy restricted the reimbursement of a previously funded deductible or portion of that deductible on a subsequent event. As a result, the reimbursement of deductibles in a second or subsequent event is now eligible in some circumstances.

In its current status, the regulation on insurance as related to the Public Assistance program is dated and has not kept up with the complexity of the insurance industry. Current regulation was drafted as an interim rule on

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<sup>43</sup> 44CFR, § 206.252(a).

<sup>44</sup> Ibid., § 206.253.

December 11, 1991.<sup>45</sup> This interim rule has been surpassed by an evolving and complex insurance industry.

Current law, regulation, and policy do not encourage insurance and hazard mitigation as directed by the Stafford Act. Regulation has yet to be promulgated for implementing a reduced federal share for facilities that have been damaged, on more than one occasion within the preceding 10-year period, by the same type of event; and the owner of which has failed to implement appropriate mitigation measures to address the hazard that caused the damage to the facility. Current law, regulation, and policy do not encourage facility owners to make sound insurance and risk management decisions in order to best protect themselves.

State, tribal, and local jurisdictions evaluate insurance protection that maximizes coverage while minimizing cost. Government policy should encourage flexibility of jurisdictions to make insurance risk management decisions that protect the taxpayer and limit a reliance on the federal support.

### **C. RESEARCH QUESTIONS**

Research into law, regulation, and policy that has shaped the current status of insurance as related to the Public Assistance program will provide a clear understanding of a path forward to better comply with existing law. In addition, the research may provide a better way forward to improve law and regulation in order to provide incentives and disincentives in order to encourage insurance, encourage hazard mitigation, promote sound insurance and risk management decision making, and protection of the taxpayer.

Through the following questions, we hope to formulate improvements to existing law, regulation, and policy to formulate better guidance that is updated and promotes fairness while following the intent of Congress as it currently exists.

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<sup>45</sup> 44CFR, § 206.250 – § 206.253.

## **1. Primary Question**

How should insurance under FEMA's Public Assistance program be shaped in order to promote sound risk management and efficient insurance coverage decision-making that promotes equitable, effective, and efficient insurance protections for the applicant, the state, the taxpayer and FEMA?

## **2. Secondary Questions**

- How would the law, regulation, and policy be re-written to promote sound judgment, efficiency, and effective insurance protection for public jurisdictions including incentives and disincentives for such decision making?
- How would a revised policy support the Stafford Act's intent of encouraging insurance coverage and supplementing state and local resources?
- How would the revised policy provide a fair burden to both the applicant and the taxpayer?
- How would the State Insurance Commissioner's authority under the Stafford Act be incorporated into the implementation of the policy?
- How would this new policy promote sound risk management?
- How would a revised policy be implemented in the field consistently and correctly?
- How would the perspective of the state government, tribal nations, local jurisdictions, and FEMA be harmonized in the adoption of a revised insurance policy in Public Assistance?
- How would the policy be shaped in order to promote mitigation of future damages?
- How can the federal government incentivize all jurisdictions to have insurance? Or, should federal policy establish a requirement of insurance?

- How should deductibles and types of insurance policies be considered in the revised guidance in following the intent of Congress?
- What is the value of reasonable when evaluating insurance deductibles and limit of liabilities?

#### **D. KEY PROVISIONS AND INTENT OF THE LAW**

Several key provisions must be highlighted as they are critical to the research at hand related to insurance and the Public Assistance program. These provisions are the focal point of the guidance on insurance in the existing structure.

- The intent of Congress with respect to insurance as defined in the Stafford Act is to encourage individuals and governments to protect themselves by obtaining insurance to supplement or replace government assistance;<sup>46</sup>
- The intent of Congress is to encourage hazard mitigation to reduce losses from disasters;<sup>47</sup>
- A requirement to obtain and maintain insurance as a condition of receiving Public Assistance grant funding;<sup>48</sup>
- A prohibition on duplication of disaster assistance benefits (from any source, including insurance proceeds);<sup>49</sup>
- Deductions from grant funding for certain uninsured facilities located in an SFHA;<sup>50</sup> and
- FEMA shall not require greater types and extent of insurance than are certified to him as reasonable by the appropriate State Insurance Commissioner responsible for such insurance.<sup>51</sup>

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<sup>46</sup> The Stafford Act, Section 101.

<sup>47</sup> Ibid., Section 101.

<sup>48</sup> Ibid., Section 311(b).

<sup>49</sup> Ibid., Section 312.

<sup>50</sup> Ibid., Section 406(d).

<sup>51</sup> Ibid., Section 311(a)(2).



## **E. SIGNIFICANCE TO THE FIELD**

The research conducted for this thesis may potentially shape the law, regulation, and policy on insurance as related to FEMA's Public Assistance program. The research will examine existing law, regulation, and policy and attempt to develop clear direction that promotes sound risk management for the applicant, the state, tribes, FEMA and the taxpayer. This research will evaluate the policy and risk management practices that benefit the various levels of jurisdictions impacted by disaster with respect to the treatment of insurance. Law, regulation, and policy are not consistent. Additionally, the law, regulation, and policy may not provide the right guidance to protect the federal investment in previously damaged facilities. The shortfall may lead to the moral hazard of over reliance on federal support and promote poor risk management.

This thesis will evaluate the shape of insurance under FEMA's Public Assistance program in order to promote sound risk management and efficient insurance coverage decision-making in order to encourage equitable, effective, and efficient guidance for the applicant, the state, the taxpayer, and FEMA.

The underlying contribution would address the following points:

- Re-write the law, regulation, and policy on insurance as related to Public Assistance to promote sound judgment, efficiency, and effectiveness while promoting sound risk management.
- Revise FEMA policy to provide a fair burden to both the facility owner and the taxpayer. Any such revision would promote consistent and correct implementation of the law and regulation in the field.
- Evaluate the State Insurance Commissioner's authority under the Stafford Act into the implementation of the policy.
- Ensure a revised policy would support the Stafford Act's intent of supplementing state and local resources. Simultaneously, this research will harmonize the perspective of the state government, local jurisdictions, and FEMA in the adoption of a revised insurance policy in Public Assistance.
- Evaluate the policy in order to promote mitigation to minimize future damages.

## **F. THESIS OUTLINE**

Chapter II will review the law as provided in the Robert T. Stafford Disaster Relief and Emergency Assistance Act as amended. The regulation is the 44 CFR specifically Section § 206.250 through Section § 206.253. At the policy level of guidance, the Public Assistance Guide, Public Assistance Digest, and a Disaster Assistance Policy on “Guidance for FEMA Field Personnel” provide the direction on insurance in the Public Assistance program. Also, a review of previous policy, which was recently rescinded, will be addressed. Then, the chapter will address the key components of insurance policy which includes past efforts in drafting law, regulation and policy, the role of the State Insurance Commissioner, address key court cases in the development of the guidance that forms the law, regulation, and policy, and conclude with the moral hazard of insurance.

Chapter III will address the background of deductibles and their role in insurance policies. The background of purpose and types of deductibles and the relationship to risk management is a key part of this chapter. Deductibles are a significant element of risk management and the chapter will address the considerations of risk financing a component of risk management. The current law and regulation as applicable to deductibles will be reviewed. Then, deductibles for flood and other than flood events will be examined as applied to FEMA's Public Assistance program.

Chapter IV will address the different types of insurance policies from blanket policies, pool arrangements, and self-insurance for both flood and other than flood hazards. Regulation, specifically § 206.253(b) (2), addresses blanket, pool arrangements or some combination as group. However, this chapter will address them separately in order to provide a more in-depth background on each type of policy.

Chapter V will address those topics as related to the obtain and maintain requirement as well as the effects on future grants if the obtain and maintain requirement is not satisfied.

Chapter VI will address the complex subject of promoting resiliency and hazard mitigation in public facilities. Both areas of interest are critical in reducing the costs of future disasters and building communities that are more resilient. Federal encouragement can enhance resiliency and stress the importance of resiliency to local communities. The chapter will also address law and regulation of hazard mitigation, mitigation planning, funding mechanisms, and government incentives for hazard mitigation.

Chapter VII will provide analysis of the insurance requirements for Australia and Canada through their equivalent of the Public Assistance program. In order to better understand the role of insurance in disaster assistance, this chapter will briefly review the style of government of each country, the declaration criteria for a disaster declaration and address the public assistance programs including insurance requirements and mitigation requirements. The analysis will then compare the programs of the three countries and evaluate the components of the programs in Australia and Canada, which could be employed in the United States. In the end, best practices from all three countries will be important in re-defining insurance law, regulation, and policy in FEMA's Public Assistance program as related to insurance.

Chapter VIII will focus on four key components related to insurance. These four focus areas will have the greatest impact on any future policy changes with the Agency and for facility owners.

Chapter IX will conclude the research and tie together any remaining questions related to this effort.

## **G. CONCLUSION**

The original source literature will provide the majority of the required documentation and literature required for this thesis. The Stafford Act, 44 CFR and Public Assistance Guide, Public Assistance Digest, and Disaster Assistance Policies are the original sources documents and they are readily available.

Literature on the history of the insurance industry is abundant. However, the critical elements of insurance history are to document the importance of the States' Insurance Commissioners and understanding the history of the state regulation of insurance.

Available literature is limited in the documentation of problems with the current law, regulation, and policy. However, the DHS-OIG Report on the program issues and FEMA's second appeal database will be sufficient to document the problems and challenges with the current structure and treatment of insurance as related to the Public Assistance program.

Chapter II will address the law, regulation, and policy in FEMA's Public Assistance program. In the process, it will explore past attempts in regulatory changes, the background of the key legal actions that have impacted insurance matters in FEMA's Public Assistance Program, the role of the State Insurance Commissioner, and the moral hazard of insurance.

## **II. LAW, REGULATION, POLICY, PAST REGULATORY ACTIONS, COURT RULINGS, APPEALS, AND OTHER CONSIDERATIONS**

FEMA activities are based on specific authorities such as the Homeland Security Act of 2002, Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act), and Homeland Security Presidential Directive 5.<sup>52</sup> Accordingly, Law, Regulation, and Policy form the insurance policy and considerations in FEMA's Public Assistance program. This chapter will review the law as provided in the Robert T. Stafford Disaster Relief and Emergency Assistance Act as amended. The regulation is the 44 CFR specifically Sections § 206.250 through Section § 206.253. At the policy level of guidance, the Public Assistance Guide, Public Assistance Digest, and a Disaster Assistance Policy on "Guidance for FEMA Field Personnel" provide the direction on insurance in the Public Assistance program. Also, a review of previous policy, which was recently rescinded, will be addressed. Then, the chapter will address the key components of insurance policy which includes past efforts in drafting law, regulation and policy, the role of the State Insurance Commissioner, key court cases in the development of the guidance that forms the law, regulation, and policy, and conclude with the moral hazard of insurance.

### **A. ROBERT T. STAFFORD DISASTER RELIEF AND EMERGENCY ASSISTANCE ACT**

The Stafford Act is the legal basis for disaster assistance in the United States. The law provides the authority for the President to declare an emergency or major disaster in order to provide federal government resources in the areas of preparedness, response, recovery, and mitigation both in funding and other assistance. The Stafford Act gives the President the authority to determine when to supplement state and local efforts and provide capabilities to save lives and to

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<sup>52</sup> Federal Emergency Management Agency, FEMA Publication 1, 17.

protect property and public health and safety, or to lessen or avert the threat of a catastrophe in any part of the United States.<sup>53</sup> For declared emergencies and major disasters, state or local government resources must be exceeded as determined by the President.

The intent of Congress is clearly delineated in the Act, which is “to provide an orderly and continuing means of assistance by the federal government to state and local governments in carrying out their responsibilities to alleviate the suffering and damage which results from such disasters.”<sup>54</sup> Several provisions in Congress’s intent relate to insurance including encouraging the development of disaster preparedness, encouraging entities to protect themselves by obtaining insurance coverage to supplement or replace governmental assistance, and encouraging hazard mitigation.<sup>55</sup>

While the authorities granted in the Stafford Act are broad in reach, many areas of assistance are prohibited by the Act. The first is duplication of benefits. Section 312 of the Stafford Act directs the President to assure that no such person, business concern, or other entity will receive such assistance with respect to any part of such loss as to which he has received financial assistance under any other program, insurance proceeds, or any other source.<sup>56</sup> Additionally, the law requires the recoupment of duplicative benefits regardless of the source.<sup>57</sup>

With respect to insurance, the intent of Congress provided by the law encompasses several areas of guidance.

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<sup>53</sup> The Stafford Act, Section 102.

<sup>54</sup> Ibid., Section 101.

<sup>55</sup> Ibid.

<sup>56</sup> Ibid., Section 312.

<sup>57</sup> Ibid.

- The Act recognizes the insurance structure in the United States and directs the President to not require greater types and extent of insurance than are certified as reasonable by the appropriate State Insurance Commissioner responsible for regulation of such insurance.<sup>58</sup>
- The Act prohibits an applicant from receiving any assistance for any property for which the applicant previously received assistance unless all insurance required pursuant to this section has been obtained and maintained with respect to such property.<sup>59</sup> Section 311 prohibits a Federal Agency from waiving the insurance requirement.<sup>60</sup>
- The Act allows a state to elect to act as a self-insurer with respect to any or all of the facilities owned by the state.<sup>61</sup> When such an election is made, the Act requires a plan in writing, acceptance at the time of the disaster declaration, and the self-insurer may not receive assistance for properties covered by such insurance.
- The Act provides intent and guidance of Congress with respect to flood insurance as well. The Act prohibits Federal disaster assistance to those applicants that have received flood disaster assistance, which was conditional on obtaining flood insurance and, subsequently, the applicant failed to maintain flood insurance as required under applicable Federal law on such property.<sup>62</sup>

Congress authorizes a disincentive for facilities sustaining repetitive loss. The minimum federal share of assistance shall not be less than 75 percent for eligible cost of repair, restoration, reconstruction, or replacement.<sup>63</sup> In cases where the same facility sustained damage from the same peril within the preceding 10 year period and the facility owner failed to implement appropriate mitigation measures to address the hazard that caused the damage to the facility, the Act authorized a reduced federal share of assistance.<sup>64</sup>

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<sup>58</sup> The Stafford Act, Section 311.

<sup>59</sup> Ibid.

<sup>60</sup> Ibid.

<sup>61</sup> Ibid.

<sup>62</sup> Ibid.

<sup>63</sup> Ibid, Section 406.

<sup>64</sup> Ibid.

The Act provides clear guidance for facilities damaged by flood inside or outside of a Special Flood Hazard Area (SFHA). The Act also directs the reduction of assistance by the lesser of the value of the facility or the maximum amount of insurance proceeds that would have been available if the facility had been covered by the flood insurance under the National Flood Insurance Act of 1968 for a facility that is located in a SFHA for greater than one year.<sup>65</sup>

## **B. 44 CODE OF FEDERAL REGULATIONS**

The 44 CFR attempts to further define the implementation of the law through regulation. The regulation is broken into two sections that apply to facilities damaged by flood and other than flood perils.

For facilities damaged by flood, an insurable building in a Special Flood Hazard Area, for more than one year, will be reduced by the maximum amount of insurance proceeds available if the facility had been covered by a standard flood insurance policy.<sup>66</sup> In addition, 44 CFR § 206.252 prescribes the requirement to obtain and maintain flood insurance in the amount of eligible disaster assistance received.<sup>67</sup> This “obtain and maintain” requirement is applicable to those facilities inside and outside the Special Flood Hazard Area. For some applications of “obtain and maintain” requirements for damages caused by flood perils, the Regional Administrator shall not require greater types and extent of insurance as certified by the State Insurance Commissioner.<sup>68</sup>

For facilities damaged by other than flood, the eligible disaster assistance costs will be reduced by the insurance proceeds for that facility. An “obtain and maintain” requirement will be placed on that facility to protect against future losses to such property from the types of hazard, which caused the major

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<sup>65</sup> The Stafford Act, Section 406(d).

<sup>66</sup> 44 CFR, § 206.252.

<sup>67</sup> Ibid.

<sup>68</sup> Ibid.



disaster.<sup>69</sup> As in cases of damage caused by flood perils, the Regional Administrator shall not require greater types and extent of insurance certified by the State Insurance Commissioner.

The 44 CFR also provides for consideration for blanket policies in order to reduce the cost of insurance. In the case of a blanket policy, eligible costs for damages occurring in a second or subsequent disaster to a facility will be reduced by the amount of eligible damage sustained on the previous disaster.

The insurance regulation in the 44 CFR was promulgated on December 11, 1991.<sup>70</sup>

### **C. FEMA'S POLICY ON INSURANCE**

The Public Assistance Guide, Public Assistance Digest, and the Disaster Assistance Policy on "Insurance Responsibilities for Field Personnel" provide the direction on insurance in the Public Assistance program. The three documents provide a greater level of detail for both applicants and field personnel in making determinations of eligibility of damage to facilities and the applicability of insurance as related to those determinations.

In a significant policy change, FEMA rescinded Disaster Assistance Policy 9580.3 which was "Insurance Considerations for Applicants" on February 8, 2013.<sup>71</sup> This was the only policy level guidance on the eligibility of certain deductibles. While the FEMA policy on insurance is under review, the recession leaves imprecise regulations and the current policy guidance open to interpretation on the eligibility of deductibles in a subsequent event.

Disaster Assistance Policy 9580.3 was issued in May 2008 and provided the FEMA policy on insurance until the rescission in February 2013. The "Insurance Considerations for Applicants" addressed in the fact sheet were

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<sup>69</sup> Ibid, § 206.253.

<sup>70</sup> 56 Federal Register 64560, December 11, 1991.

<sup>71</sup> Deborah Ingram, "Disaster Assistance Fact Sheet 9580.3, Insurance Considerations for Applicants," Letter of February 8, 2013.

predominately covered in other law and regulation, specifically the Stafford Act and 44 CFR § 206.250, § 206.252 and § 206.253. The fact sheet presented all insurance related considerations in one document, including Applicant responsibilities in the Public Assistance process, insurance requirements as condition of the federal grant, and provided answers to frequently asked questions. The frequently asked questions covered two significant areas either not addressed or clarified in law or regulation. One, the apportionment of insurance to address insurance proceeds received for eligible and ineligible damages. An example of ineligible insurance proceeds could be business interruption, which is not eligible under the Public Assistance program. Two, the fact sheet addressed deductibles in the first and subsequent events and the apportionment of deductibles for eligible and ineligible damages. The recession of the fact sheet commenced a debate on the eligibility of deductibles in a first or subsequent event. The frequently asked questions section also addressed self-insurance, obtain and maintain requirements, and the State Insurance Commissioners certification all of which are also addressed in law and regulation.

#### **D. PAST EFFORTS IN DRAFTING REGULATION**

In February 2000, FEMA made a significant effort in insurance reform through the Advance Notice Proposed Rulemaking process.<sup>72</sup> The proposed insurance requirements were an effort to achieve national consistent level of responsibility among public and certain private non-profit entities for natural disaster risks.<sup>73</sup> The insurance requirement was meant to focus on damage to buildings and regulation shortfalls, specifically actual cash value or replacement cost value policy types and deductibles. Current regulation does not address a requirement of policy types and deductibles.

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<sup>72</sup> Federal Register, "Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program" February 23, 2000, No. 36.

<sup>73</sup> Ibid.

The proposed insurance requirement focused on the following problems in current policy:<sup>74</sup>

- Current disincentives to Insurance. FEMA provides a disincentive for insurance as FEMA will pay for building repair costs whether the building had insurance or not. The same is true for deductibles, as current policy does not incentivize low to moderate deductibles.
- Fairness. After a presidential declaration, public assistance funds the federal cost share of, typically, 75% for all eligible building repair costs that is not covered by insurance. The proposed insurance regulation addressed the equity between the building owner that paid insurance premiums throughout the years and the building owner that has no insurance and saved those expenses.
- Other Issues. These concerns primarily addressed the shortfalls in regulations in defining insurance, regulations for damages less than the building owner's deductible, regulations do not address the types of insurance needed (actual cash value or replacement cost value), nor does current regulation provide any policy or guidance the State Insurance Commissioners' determination under the Stafford Act that insurance is not reasonably available.

The proposed rulemaking was focused on the standards of affordability, availability, private sector, and fairness. In addition, three options were discussed but the option that provided the best alternative to meet the intent and specific provisions of the Stafford Act was represented by the requirement of insurance in order to receive Public Assistance, defining insurance, standards for deductibles, addressing the policy issues where regulation was silent. The proposed regulation suggested the insurance amounts in Table 1 as adequate insurance in each of the categories.<sup>75</sup>

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<sup>74</sup> Ibid.

<sup>75</sup> Federal Register, "Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program," February 23, 2000, No. 36.

Categories of Insurance	Individual building by building policy	Blanket Policy
ALL-RISK	Minimum of 80% Replacement Cost Value (RCV)	Minimum of 80% RCV, or 110% of the total building value at the applicant's highest-valued single location.
EARTHQUAKE	35% of total building value of \$1M or less; 25% of the next \$9M of building value; 20% of the building value over \$10M, with a maximum coverage limit of \$125 M.	35% of the total insurable building values of \$1M or less; 10% of the next \$9M building value; 5% of the building value over maximum coverage limit of \$125M.
FLOOD	Maximum offered by NFIP per building.	Total limit equal to or greater than the combined total limits obtained under separate NFIP policies.
WIND	Minimum of 80% of its insurable value up to \$125M	Not less than 80% of the total insurable values at the applicant's highest-valued single location up to \$125M.

Table 1. Proposed insurance requirements (from Federal Register, “Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program” February 23, 2000, no. 36)

The intent of the proposed insurance requirement was not to over burden building owners with exorbitant insurance premiums. The schedule above was qualified by a cap of insurance premiums at \$0.30 per \$100.

The proposed insurance requirement also defined deductible requirements, which is included in Table 2.

Categories of Insurance	Individual building by building policy	Blanket Policy
ALL-RISK	0.1% of the building's insurable value with a maximum of \$100,000 per occurrence.	0.1% of the building's insurable value with a maximum of \$100,000 per occurrence for all buildings involved.
EARTHQUAKE	Maximum of 7.5% of the insurable value of the building.	Maximum of 7.5% of the insurable value of the building(s).
FLOOD	Maximum of \$1,000.	2% of the total insurable values of the building(s) involved with a maximum of \$25,000.
WIND	Maximum 5% of the insurable value of the building with a maximum value of \$100,000 per occurrence.	Maximum 5% of the total insurable value of the building(s) involved with a maximum value of \$100,000 per occurrence for all buildings involved.

Table 2. Proposed insurance deductibles (from Federal Register, "Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program," February 23, 2000, No. 36)

The proposed maximum premium threshold was in effort to provide a safety net provision to balance cost considerations with a minimal standard of sound insurance coverage. This provision was to ensure that a facility owner would not be overburdened with insurance costs. The proposed insurance premium cap was \$0.30 per \$100 of building replacement cost value.<sup>76</sup>

The proposal also provided recommended guidance to the State Insurance Commissioner in their authority to certify the types and extent of insurance reasonably available. As guidance does not currently exist, the recommendation was setting boundaries for the State Insurance Commissioner based on cost of insurance by the type of peril. The proposal would limit the State Insurance Commissioners ability to waive the requirement of insurance or insurance less than the .3% minimum threshold of insurance.

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<sup>76</sup> Federal Register, "Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program" February 23, 2000, No. 36.

The feedback from the Federal Register Notice was overall very negative. Of the 291 comments, only 25 (8.59%) were positive. The 196 negative comments totaled 67% of the total comments. The 68 neutral comments comprised the remaining 23% of the overall comments.

Further analysis of the overall responses provided additional insight. Of the 291 responses, 43% were local governments, 12% were insurance corporations, and 8% were state governments. The federal government comprised less than 3% of the responses. Table 3 summarizes the overall results of the responses.

Type of Entity	Total		Positive		Negative		Neutral	
Local								
Government	126	43.30%	4	3.17%	107	84.92%	15	11.90%
Insurance Corporation	35	12.03%	8	22.86%	17	48.57%	10	28.57%
State								
Government	29	9.97%	5	17.24%	8	27.59%	16	55.17%
Association	25	8.59%	2	8.00%	16	64.00%	7	28.00%
Small Entity	22	7.56%	1	4.55%	17	77.27%	4	18.18%
Other	15	5.15%	1	6.67%	9	60.00%	4	26.67%
Private Non-Profit								
Organization	13	4.47%	0	0.00%	10	76.92%	3	23.08%
University	13	4.47%	1	7.69%	8	61.54%	3	23.08%
Federal Government	8	2.75%	2	25.00%	1	12.50%	5	62.50%
Individual	3	1.03%	1	33.33%	1	33.33%	1	33.33%
Other - District	1	0.34%	0	0.00%	1	100.00%	0	0.00%
Other-Society	1	0.34%	0	0.00%	1	100.00%	0	0.00%
<b>Total</b>	<b>291</b>		<b>25</b>	<b>8.59%</b>	<b>196</b>	<b>67.35%</b>	<b>68</b>	<b>23.37%</b>

Table 3. Summary of responses by entity (from Federal Register, "Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program," February 23, 2000, No. 36)

The local governments were overwhelmingly negative on the concept with an 84% negative response. Of the 291 comments, 32 states, including Guam and Puerto Rico, responded. The top seven states are listed in the Table 4 and show that California represented 63% of the total responses. The majority of

those responses were focused on earthquake coverage.<sup>77</sup> This is logical as the state was still in the recovery process from damages caused by the 1994 Northridge Earthquake. The top seven states represent 82% of the responding states. The totals in the Table 4 represent overall comments from all 32 responding states.

				Positive		Negative		Neutral	
<b>State</b>	CA	184	63.23%	1	0.54%	164	89.13%	18	9.78%
	WA	18	6.19%	6	33.33%	3	16.67%	9	50.00%
	DC	14	4.81%	3	21.43%	6	42.86%	5	35.71%
	FL	11	3.78%	2	18.18%	3	27.27%	6	54.55%
	MO	4	1.37%	1	25.00%	0	0.00%	3	75.00%
	IN	4	1.37%	0	0.00%	2	50.00%	2	50.00%
	MA	4	1.37%	0	0.00%	3	75.00%	1	25.00%
<b>Total (all states)</b>		<b>291</b>		<b>25</b>	<b>8.59%</b>	<b>196</b>	<b>67.35%</b>	<b>68</b>	<b>23.37%</b>

Table 4. Summary of responses by state (from Federal Register, “Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program,” February 23, 2000, No. 36)

Since the responses from California were such a large component of the overall comments, was the response still negative when statistically removing California from the data? Table 5 represents the data by entity after removing all California responses. Surprisingly, the results are neutral with 22% positive, 30% negative, and 47% neutral.

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<sup>77</sup> Federal Register, “Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program,” October 2, 2000, No. 191.

<b>Type of Entity (Minus California)</b>			<b>Positive</b>		<b>Negative</b>		<b>Neutral</b>	
Local Government	19	17.76%	4	21.05%	7	36.84%	8	42.11%
Insurance Corporation	15	14.02%	7	46.67%	1	6.67%	7	46.67%
State Government	22	20.56%	5	22.73%	3	13.64%	14	63.64%
Association	17	15.89%	2	11.76%	9	52.94%	6	35.29%
Small Entity	5	4.67%	1	20.00%	2	40.00%	2	40.00%
Other	4	3.74%	1	25.00%	1	25.00%	2	50.00%
Private Non-Profit Organization	4	3.74%	0	0.00%	2	50.00%	2	50.00%
University	10	9.35%	1	10.00%	5	50.00%	3	30.00%
Federal Government	8	7.48%	2	25.00%	1	12.50%	5	62.50%
Individual	3	2.80%	1	33.33%	1	33.33%	1	33.33%
Other - District	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Other-Society	0	0.00%	0	0.00%	0	0.00%	0	0.00%
<b>Total</b>	<b>107</b>		<b>24</b>	<b>22.43%</b>	<b>32</b>	<b>29.91%</b>	<b>50</b>	<b>46.73%</b>

Table 5. Summary of responses by entity (minus California) (from Federal Register, "Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program" February 23, 2000, No. 36)

The specific overall comments were analyzed by FEMA in the following topics: Adequate Insurance, Premium Thresholds, Self-Insurance, and Deductibles.<sup>78</sup>

The Adequate Insurance comments focused primarily on earthquake insurance. The comments contend that the private insurance market does not have the capacity to provide adequate coverage.<sup>79</sup> The result is higher premiums with limited coverage for insurance coverage that is typically separate and apart from other property insurance. The comments, especially from California, contend that an eligibility requirement involving earthquake insurance is unreasonable both in premiums charged and insurance maximum coverage limit of \$125 million.<sup>80</sup>

<sup>78</sup> Federal Register, "Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program," October 2, 2000, No. 191.

<sup>79</sup> Ibid.

<sup>80</sup> Federal Register, "Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program," October 2, 2000, No. 191.



The comments on premium thresholds were in agreement of the need for a safety net provision in the form of a premium threshold.<sup>81</sup> The comments varied on the \$0.30 per \$100 being too high compared to current rates and that setting an absolute dollar value threshold will promote insurance companies to set prices based on the threshold.

The self-Insurance comments support the option for all entities who chose to make the self-insurance election.<sup>82</sup>

The comments on deductibles were mixed between the deductible being the responsibility of the insured and not funded by FEMA and the majority suggested otherwise.<sup>83</sup>

Other comments addressed the benefit of providing incentives to those entities that have insurance or addressed the administrative burden of eligibility determinations based on pre-disaster insurance requirements.

The DHS-OIG recommended that FEMA complete this rulemaking process and issue a final rule that resolves the longstanding problems with Public Assistance insurance regulations, including topics of deductibles, self-insurance, and the State Insurance Commissioners' determinations of reasonably available insurance, among other concerns.<sup>84</sup>

## **E. ROLE OF THE STATE INSURANCE COMMISSIONER**

The authority of the State Insurance Commissioner is clearly defined in the history of insurance in the United States and in legal and regulatory guidance for FEMA's Public Assistance program. Our history is unambiguous that states regulate insurance in the United States.<sup>85</sup> Each state has an Insurance Commissioner that has been appointed by Governor or has been elected

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<sup>81</sup> Ibid.

<sup>82</sup> Ibid.

<sup>83</sup> Ibid.

<sup>84</sup> Beard, FEMA's Process for Tracking Public Assistance Insurance Requirements, 13.

<sup>85</sup> Randall, Insurance Regulation in the United States, 626.

depending on the state. Of the 56 states and Territories, 44 of the State Insurance Commissioners are appointed or 78.6%. The remaining 12 or 21.4% are elected. Thirteen of the State Insurance Commissioners hold a secondary Office that ranges from Lieutenant Governor to Fire Marshall.

The power of this position has been upheld through the court systems at the state and federal level. The United States Supreme Court recognizes that insurance is a business of public interest as consumers invest a substantial sum for insurance coverage in advance with the value of insurance being the future performance of those obligations.<sup>86</sup> In protection of the consumer, government regulation can ensure solvency and the insurer's ability to pay claims in the future, standardize policy coverage, require minimum coverage, and require fair claims processing.<sup>87</sup>

The marked history and conflict between the federal and state governments began in 1868. Throughout the mid-1800's, several state legislatures created independent administrative agencies to supervise insurance within the state borders. As the insurance operations extended across state lines, the insurance industry sought federal regulation in order to avoid multiple state regulations, preferring what was expected to be weak federal regulation to sometime aggressive state oversight.<sup>88</sup> The insurance industry challenged in the Supreme Court that the regulation of insurance resided in the federal government. However, the Court held, in the case *Paul v. Virginia*, that "issuing a policy of insurance is not a transaction of commerce." This challenge in the nation's highest court placed the burden of insurance regulation on the states.<sup>89</sup>

The Supreme Court maintained its position that insurance was not subject to federal regulation and attempts to amend the Constitution to permit the federal government to regulate insurance failed.

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<sup>86</sup> Ibid., 627.

<sup>87</sup> Ibid., 627.

<sup>88</sup> Ibid., 630.

<sup>89</sup> Randall, Insurance Regulation in the United States, 631.

In 1871, the New York Superintendent of Insurance organized the initial meeting of what would become the National Association of Insurance Commissioners (NAIC).<sup>90</sup> The New York superintendent of insurance asked the insurance commissioners across all thirty-six states to attend a meeting to discuss insurance regulation. Representatives of nineteen states attended, marking the beginning of what was then known as the National Insurance Convention.<sup>91</sup> At the second meeting later that same year, all thirty six insurance regulators attended.

As the industry evolved, the insurance regulators' responsibilities grew in scope and complexity although insurance rate regulation was still largely uncontrolled in the United States.<sup>92</sup> In another key development in the history of the insurance, the Supreme Court (*United States v. Southeastern Underwriters*) ruled to overturn the *Paul v. Virginia* decision in 1944 due to a debate over bribery, conspiracy to defraud the state and policyholders, price fixing, and limited competition. In the *Southeastern Underwriters* case, the United States Supreme Court held that insurance was indeed commerce and subject to federal regulation under the Commerce Clause.<sup>93</sup> With the sudden shift in state regulatory and tax authority, NAIC proposed a bill, which was introduced by Congress the next year. The McCarran-Ferguson Act passed in 1945 to declare that the business of insurance is subject to state law.<sup>94</sup> The McCarran-Ferguson Act clarified that states should continue to regulate and tax the business of insurance and affirmed that the continued regulation of the insurance industry by the states was in the public's best interest.<sup>95</sup> Federal law only supersedes state insurance regulation if it specifically relates to the business of insurance, which meant that Congress retained Commerce Clause authority of insurance

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<sup>90</sup> Ibid.

<sup>91</sup> Ibid., 632.

<sup>92</sup> Ibid.

<sup>93</sup> Ibid., 633.

<sup>94</sup> NAIC, *State Insurance Regulation*, 2.

<sup>95</sup> Randall, *Insurance Regulation in the United States*, 633.

companies.<sup>96</sup> In addition, if states did not regulate the business of insurance, federal law would apply. NAIC responded by drafting model laws to demonstrate that the states were regulating insurance and to preclude federal intervention. By the early 1950's, most states enacted these laws.<sup>97</sup> As a result, the business of insurance regulation rests within the borders of each state.

The mission of the NAIC is to assist state insurance regulators, individually and collectively, in serving the public interest and achieving the following fundamental insurance regulatory goals in a responsive, efficient and cost effective manner, consistent with the wishes of its members. Specifically:

- Protect the public interest;
- Promote competitive markets;
- Facilitate the fair and equitable treatment of insurance consumers;
- Promote the reliability, solvency and financial solidity of insurance institutions; and
- Support and improve state regulation of insurance.

The State Insurance Commissioner has tremendous power in the implementation of insurance policy. The President cannot require greater types and extent of insurance than are certified as reasonable by the appropriate State Insurance Commissioner.<sup>98</sup> The Insurance Commissioner's certification can reduce the obtain and maintain requirement by the insurance that is reasonably available. As a result, the State Insurance Commissioners are a key component in the implementation of the insurance considerations in FEMA's Public Assistance program.

The history of insurance regulation and formation of law in supplanting the regulation of insurance to the states provide the background in the authority of the State Insurance Commissioner in all matters related to insurance regulation, including in FEMA's Public Assistance program.

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<sup>96</sup> Ibid., 634.

<sup>97</sup> Ibid.

<sup>98</sup> The Stafford Act, Section 311.

## **F. KEY COURT CASES RELATED TO INSURANCE IN FEMA'S PUBLIC ASSISTANCE PROGRAM**

While there are many instances of court rulings on associated FEMA programs in the areas of freedom of information, the National Flood Insurance Program, and FEMA travel trailers. A single key court case addresses the implementation of insurance regulation through FEMA's Public Assistance program.

### **1. State of Hawaii vs. Federal Emergency Management Agency**

This case focuses on the key points surrounding the meaning of available benefits, reasonable perseverance, risk averseness, and duplication of benefits.

Hurricane Inki impacted the Hawaiian island of Kauai in 1992, causing an estimated \$2.6 billion in damages.<sup>99</sup> Hurricane Inki was the largest disaster ever to hit the State of Hawaii.

The State of Hawaii sustained damage to 16 state facilities as a result of the hurricane. After some deliberation, the state settled with their insurance companies for \$42.7 million.<sup>100</sup> The settlement was made in order to expedite recovery by providing "the best results in terms of restoring the buildings in the most efficient and timely manner" as argued by the Hawaii comptroller. While the state could have settled based on actual costs with the insurance company, the loss estimate basis would reduce the accountability to the insurers and would speed the pace of recovery, as the insurers would not be involved in developing the scope of work, overseeing the bidding process, and resolving cost and constructions issues during the replacement process. The settlement was below the \$50 million policy limit.

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<sup>99</sup> State of Hawaii, Attorney General vs. FEMA, No. 00-15895, argued November 5, 2001, Submitted June 26, 2002, State of Hawaii Circuit Court.

<sup>100</sup> Ibid.

To facilitate repairs and the recovery process, FEMA mission assigned the U.S. Army Corps of Engineers (USACE) to perform work at the 16 sites in removing debris and making emergency temporary repairs to schools, armories, a hospital and a community college on the island in order to expedite the reestablishment of the community.<sup>101</sup> The cost of the mission assignment to the USACE was roughly \$12.1 million. During an Office of Investigator General (OIG) Audit, the determination was made the 12.1 million as a duplication of benefits as the repairs were included in the \$42.7 million settlement with the State's insurance companies. The State filed a first appeal to the Regional Administrator, a second appeal to the Associate Administrator for Response and Recovery, and then in the State of Hawaii Circuit Court. The State submitted that \$7.4 million was work performed on the 16 facilities. The dispute was \$4.7 million, or the difference between the \$12.1 million and \$7.4 million.<sup>102</sup>

The State argued that the Stafford Act restricts a duplication of benefit when a party has already received the financial assistance for its loss. Since the assistance provided was not financial assistance, it was not a duplication of benefits. Additionally, the State argued that the benefit may be available to a person if they actually obtain the benefit.<sup>103</sup>

FEMA argued that the USACE work, which FEMA paid for through the mission assignment, was a duplication of benefits and that the State should repay the entire \$12.1 million.<sup>104</sup> However, FEMA's technical assistance close out team could only substantiate the \$7.4 million the amount that the State of Hawaii received from their insurers. However, FEMA argued that the

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<sup>101</sup> FEMA, Second Appeals Database, FEMA-0961-DR-HI, State of Hawaii, March 6, 1999.

<sup>102</sup> State of Hawaii, Attorney General vs. FEMA, No. 00-15895, argued November 5, 2001, Submitted June 26, 2002, State of Hawaii Circuit Court.

<sup>103</sup> Ibid.

<sup>104</sup> State of Hawaii, Attorney General vs.. FEMA, No. 00-15895, argued November 5, 2001, Submitted June 26, 2002, State of Hawaii Circuit Court.

\$12.1 million was the total cost of the USACE repairs to the 16 facilities was not greater than the State's \$42.7 million insurance settlement.<sup>105</sup>

The Circuit Court concluded that the proper approach to “determining if a disaster aid recipient adequately sought out “available” benefits is to inquire whether the recipient acted in a commercially reasonable manner in determining the amount of insurance proceeds to accept. Because Hawaii so acted, it owes FEMA, under §5155(c) of the Stafford Act, only the amount of insurance proceeds it actually received to make the disputed repairs.”<sup>106</sup>

The Court took great lengths to define “available” in their ruling. Available was defined as the resources available to the same person for the same purpose from another source. The benefit of available resources actually received and benefits that would have been received if the person acted in a commercially reasonable manner with regard to the settlement claim. The Stafford Act does not require an insured disaster survivor to pursue a course of action to obtain insurance benefits that disregards “competing considerations” that any other person would reasonably take into account. The Stafford Act requires disaster survivors to seek out benefits with the perseverance and risk averseness that a party acting commercially reasonable manner would.<sup>107</sup> Reckless litigation, accepting settlement offers that could result in unreasonable delays, or hiring expert negotiators at excessively high rates are not a component of commercially reasonable manner.

In the Court's ruling, several points were made by the circuit court judges, which did not agree with either party. A duplication of benefits existed whether the State actually received the benefits or not, which was contrary to the State's argument. In other words, the State has the responsibility to pursue benefits under its insurance policies. However, contrary to FEMA's argument, a

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<sup>105</sup> Ibid.

<sup>106</sup> Ibid.

<sup>107</sup> Ibid.

duplication of benefits existed in the form of the insurance payment and other available sources, but only if commercially reasonable. With respect to other sources of assistance, a duplication of benefits existed if the work was performed by another entity, which was the USACE in this case. The State was the recipient of assistance from the USACE, which was duplicative of the insurance proceeds received.

The court ruled that the State of Hawaii was only liable for \$7.4 million of the \$12.1 million for work performed by the USACE, which represented the verifiable duplication of benefits received by the State.

## **G. FEMA SECOND APPEALS**

FEMA offers the right to appeal with every project worksheet. If the applicant disagrees with FEMA's determination in drafting the PW, the applicant may appeal the determination through the grantee within 60 days of that determination. This first appeal is to the Regional Administrator of the applicable FEMA region. After the Regional Administrator makes the determination, the applicant has 60 days to file a second appeal to the Associate Administrator for Response and Recovery who makes the final determination. Second appeal determinations are maintained in a database for the public and offer insight as to the policy, regulatory, and law interpretations of FEMA headquarters.

As of August 12, 2013, there were 1,838 second appeals covering a span from about 1997 to present. All appeals are categorized into the subject and nature of the appeal for simplified tracking and research. Of the nearly 1900 second appeals, emergency protective measures, debris removal, and general eligibility are the top three categories of second appeals. These categories comprise about 7% each of all second appeals. Insurance ranks 19<sup>th</sup> on the list of second appeals categories and comprises about 2.4% of all second appeals.

Of the 43 second appeals regarding insurance, eight contribute to the subject at hand. These appeals provide considerations on insurance at FEMA headquarters between 1999 and today. Of the eight appeals, three were



approved or 37.5%. All three of the approvals were related to insurance deductibles. For comparison, 22.5% of the 43 insurance related appeals were approved and 24.3% were approved or partially approved of the nearly 1900 second appeals. As previously discussed, the State of Hawaii second appeal was later overturned by the 9<sup>th</sup> Circuit Court decision, State of Hawaii vs FEMA.

The eight second appeals listed in Table 6 either have a bearing on the implementation of law, regulation, and policy or show the shifting tides in the implementation of policy. The eight second appeals fall into four narrowly defined areas of duplication of benefits, deductibles, insurance requirements, and mandatory NFIP reductions.

<b>Subject</b>	<b>Applicant</b>	<b>Disaster</b>	<b>Date</b>	<b>Amount</b>	<b>Decision</b>
Insurance Deductible	Tennessee Department of General Services	FEMA-1215-DR-TN	2/24/1999		Approval
Duplication of Benefits	State of Hawaii	FEMA-0961-DR-HI	3/6/1999	\$12,167,381	Denial
Insurance Deductible	Nashville & Davidson	FEMA-1215-DR-TN	10/6/1999	\$1,736,000	Approval
Mandatory NFIP Deductions	City of Logan	FEMA-1763-DR-IA	3/11/2010	\$15,987	Denial
Insurance Deductible	Catholic Bishop of Chicago	FEMA-1800-DR-IL	12/20/2010	\$545,082	Approval
Insurance Requirement	St. Lucie County	FEMA-1785-DR-FL	12/15/2011	\$6,601	Denial
Insurance	City of Snoqualmie	FEMA-1817-DR-WA	2/15/2012	\$11,201	Denial
Insurance Requirement	St. Lucie County	FEMA-1785-DR-FL	5/31/2012	\$20,096	Denial

Table 6. List of second appeals related to Insurance (from FEMA.gov, <http://www.fema.gov/appeals>)

The second appeal by the State of Hawaii has already been address in the 9<sup>th</sup> Circuit Court's findings. As addressed in that section, the court overturned the appeal determination.

The second appeals by the Catholic Bishop of Chicago, Tennessee Department of General Services, and Metropolitan Government of Nashville and Davidson County all pertain to deductibles. All three of these appeals were approved.

The Catholic Bishop of Chicago maintained a Self-Insured Retention and two commercially purchased insurance policies that were triggered when damages exceeded the \$1 million Self-Insured Retention.<sup>108</sup> In the project worksheet formulation and first appeal, the Self-Insured Retention was treated as self-insurance vice being a deductible prior to triggering payment from the two commercially purchased insurance policies. The second appeal considered the Self-Insured Retention as the deductible that was funded by the applicant before the commercially purchased insurance.

The Tennessee Department of General Services maintained a \$5 million annual loss aggregate deductible with \$5,000 per occurrence deductible. The State appropriates \$5 million annually for the “retention fund” to cover the deductible amount. State agencies that are responsible for individual properties would be responsible for the \$5,000 deductible per loss.<sup>109</sup> Again, the second appeal was approved as the \$5,000 per loss deductible was the disaster related losses by state agencies. The \$5 million annual loss aggregate deductible was a retention fund established by the State prior to the availability of commercial insurance. The appropriation by the State of Tennessee is not a duplication of benefits as the State is the source of funding. A duplication would only occur if the funding was from an “other source” as defined by Section 312 of the Stafford Act.<sup>110</sup> Nor should the \$5 million annual loss aggregate deductible be considered self-insurance as the commercially purchased policies are triggered when damages exceed \$5 million. The policy structure would be considered a blanket policy and the \$5 million annual loss aggregate deductible would be subject to the restrictions on deductibles codified in regulation if the facilities sustained damage in a future declared major disaster.<sup>111</sup>

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<sup>108</sup> Deborah Ingram, “Second Appeal-Catholic Bishop of Chicago, PA ID 031-U94DN-00, Insurance,” FEMA-1800-DR-IL, 18 Project Worksheets, Letter of December 20, 2010.

<sup>109</sup> Lacey Suiter, “Insurance Deductible on Facilities Damaged by Tornado, FEMA-1215-DR-TN,” Letter of February 24, 1999.

<sup>110</sup> The Stafford Act, Section 312.

<sup>111</sup> 44 CFR, § 206.253(b)(2) for other than flood or 44 CFR, § 206.252 for flood.

Metropolitan Government of Nashville and Davidson County maintained a blanket insurance policy with an annual loss aggregate deductible of \$2 million with per loss deductible of \$10,000. In the project formulation and first appeal, the deductible was considered self-insurance which was viewed differently in the second appeal.<sup>112</sup>

The second appeals by Saint Lucie County pertained to the requirement to obtain and maintain insurance on facilities as a condition of receiving assistance. The applicant failed in both cases to obtain and maintain insurance in the amount of eligible assistance provided. In both cases, FEMA reduced the project worksheets referenced in both appeals to zero dollars as the applicant received assistance in a previous disaster that included a requirement to obtain and maintain insurance as a condition of future eligibility.<sup>113</sup> Both appeals were denied citing requirement to obtain and maintain insurance as a condition of receiving assistance.

The appeal by the City of Logan and the City of Snoqualmie are somewhat related as the applicants are appealing NFIP policy mandatory reductions or obtain and maintain requirements with blanket policies. Both applicants had blanket policies, sustained damage for the first time, were located in a SFHA, and were subject to the mandatory NFIP reduction.

The City of Logan second appeal referenced buildings located in a Special Flood Hazard Area. The applicant stated they had a blanket policy with a \$100,000 deductible and FEMA should fund the total amount of damages as the damages were less than the deductible. The second appeal addressed the \$5,000 deductible in a Standard NFIP policy and denied the appeal based on the requirement to reduce the amount of assistance for facilities that are located in a

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<sup>112</sup> Lacey Suiter, "Second Appeal—Metropolitan Government of Nashville and Davidson County, Insurance Deductible, FEMA-1215-DR-TN," Letter of October 6, 1999.

<sup>113</sup> Deborah Ingram, "Second Appeal—St Lucie County, PA ID 111–99111-00, Insurance Requirement, FEMA-1785-DR-FL, Project Worksheets 803, 1884, 1921," Letter of December 15, 2011; and Deborah Ingram, "Second Appeal—St Lucie County, PA ID 111–99111-00, Insurance Requirement, FEMA-1785-DR-FL, Project Worksheets 1882," Letter of May 31, 2012.

SFHA by the amount of insurance which would have been received had the buildings and its contents been insured by the standard NFIP policy.<sup>114</sup> The appeal did not state whether the blanket policy met the obtain and maintain requirements for the facility as a condition of the grant.

In a related appeal, the City of Snoqualmie appealed the requirement to obtain and maintain insurance as a condition of receiving assistance. The applicant was not appealing the requirement to reduce the amount of assistance for facilities that are located in a SFHA by the amount of insurance which would have been received had the buildings and its contents been insured by the standard NFIP policy. The applicant was appealing FEMA's determination that their blanket policy did not meet the obtain and maintain requirement as a condition of the grant. In the appeal, the applicant claimed they had a municipal self-insurance pool through Washington Cities Insurance Authority and that the blanket policy meets the obtain and maintain requirement through commercial insurance and self-funded pooling.<sup>115</sup> FEMA determined that while § 206.252 did not prohibit blanket or pool insurance, when read in conjunction with § 206.253(b) blanket or insurance pool arrangements may only be used for facilities damaged by disasters other than flood. As a result, the appeal was denied.<sup>116</sup>

## **H. MORAL HAZARD OF INSURANCE**

The term "moral hazard" is used to describe a situation in which one of the parties to an agreement has an incentive to act in a manner that benefits them at the expense of the other party. Moral hazard also affects government programs

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<sup>114</sup> Elizabeth Zimmerman, "Second Appeal—City of Logan, PA ID 085–46155-00, Mandatory NFIP Deduction, FEMA-1763-DR-IA, Project Worksheets 1748," Letter of March 11, 2010.

<sup>115</sup> Deborah Ingram, "Second Appeal—City of Snoqualmie, PA ID 033–65205-00, Insurance, FEMA-1817-DR-WA, Project Worksheets 1617," Letter of February 15, 2012.

<sup>116</sup> Ibid.

that provide benefits, thereby relieving the people who benefit from the protection, from having the responsibility for mitigation.<sup>117</sup>

Moral hazard is defined as a failure most commonly associated with insurance. Furthermore, moral hazard is also associated with a wide variety of public policy scenarios, from environmental disaster relief to a multitude of other government programs. Moral hazard describes the danger that, in the face of insurance, a jurisdiction will increase their exposure to risk.<sup>118</sup> In other words, moral hazard is the tendency of insured parties to assume risks that they would not otherwise assume.<sup>119</sup> This increased exposure to risk places an over-reliance on the federal government and the taxpayer for support.

*Appleman's on Insurance* defines moral hazard exists when the insured has less incentive to take fewer precautions because of the existence of insurance.<sup>120</sup> When ignored, the insured would be tempted to engage in harm-generating misconduct or other reckless behavior.

Furthermore, assignment of responsibility for disaster relief to the federal government, coupled with state and local government responsibility for disaster avoidance, creates a misalignment of incentives. Disaster avoidance is a state and local responsibility through efforts in insurance and risk management. Government policy transfers these costs to the federal government, and thus to federal taxpayers and the broader society, in the form of reduced disaster relief expenditures can be viewed as a form of moral hazard, attributable to the federal policy for disaster relief.<sup>121</sup>

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<sup>117</sup> Milet, *Disasters by Design*, 158.

<sup>118</sup> Benjamin Hale, "What's So Moral about Moral Hazard?" (Public Affairs Quarterly, No. 1, January 2009), 1.

<sup>119</sup> *Ibid.*, 2.

<sup>120</sup> *New Appleman Insurance Law Practice Guide*, 2012, Matthew Bender & Company, a member of the Lexis Nexis Group, 31.06, 5.05[1].

<sup>121</sup> David E. Wildasin, "Disaster Policies: Some Implications for Public Finance in the U.S. Federation" (Public Finance Review, No. 4, 2008), 516.

Moral hazard in economic and policy disciplines is accepted market failures implying when moral hazards occur something has gone morally awry.<sup>122</sup> However, in the discipline of federal policy through government disaster assistance programs, moral hazard is better defined as jurisdictions making decisions on risk management and insurance based on government programs that incentivize such behavior. This is the hazard that a sound federal policy on insurance can correct.

## **I. CONCLUSION**

This chapter has set the foundation of the law, regulation, and policy in FEMA's Public Assistance program, past attempts in regulatory changes, the background of the State of Hawaii vs FEMA, the role of the State Insurance Commissioner, and the moral hazard of insurance. The Stafford Act provides adequate guidance on insurance and the intent of Congress on the role of insurance in FEMA's Public Assistance program. However, the guidance provided in the 44 CFR has not kept up with the industry. The insurance section in the 44 CFR is dated and provides ambiguous guidance on insurance regulation. At the policy level of guidance, FEMA policy has changed with the rescission of the fact sheet "Insurance Considerations for Applicants." In reviewing FEMA's guidance as established in policy, second appeals, and past rulemaking attempts, we can better understand the mindset of FEMA policy-makers on insurance. Finally, the moral hazard of insurance is important as policy revisions are considered in creating a policy that encourages applicants to have adequate insurance and make sound risk management decisions. Conversely, federal policy is critical as law, regulation, and policy on insurance must not inhibit sensible insurance decision making for facility owners.

In Chapter III, we will address deductibles from the view of the insured and how deductibles should be viewed in FEMA's Public Assistance program.

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<sup>122</sup> Hale, "What's So Moral about Moral Hazard?" 3.

### **III. DEDUCTIBLES**

Deductibles are a critical component of an insurance policy and considerations of deductibles can be contentious in the implementation of FEMA's Public Assistance policy. This chapter will address the background of deductibles and their role in insurance policies. The purpose and types of deductibles and their relationship to risk financing as a key component of risk management will be addressed in this chapter. In addition, the current law and regulation as applicable to deductibles will be reviewed. Then, deductibles for flood and other than flood events will be examined as applied to FEMA's Public Assistance program.

#### **A. THE ROLE OF DEDUCTIBLES**

A deductible is provision by which a specified amount is subtracted from the total loss that otherwise would be payable.<sup>123</sup> Deductibles serve three purposes: (1) eliminate small claims, (2) reduce premiums, and (3) reduce moral hazard. One, the elimination of small claims reduces the insurance company's expenses, in processing these claims. Two, the benefit to the insured is the reduced premium for insurance in exchange for the deductible. The size of the deductible has a direct correlation to the insurance premium. Three, the deductible also reduces the moral hazard of fraudulent claims or claims from carelessness or indifference to a loss.<sup>124</sup> Moral hazard was addressed in a previous chapter but is defined as a failure most commonly associated with insurance. Furthermore, moral hazard is also associated with a wide variety of public policy scenarios, from environmental disaster relief to a multitude of other government programs. Moral hazard describes the danger that, in the face of insurance, a jurisdiction will increase their exposure to risk.<sup>125</sup> In other words,

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<sup>123</sup> George E. Rejda and Michael J. McNamara, *Principles of Risk Management and Insurance* (Pearson Education, 2013), 189.

<sup>124</sup> *Ibid.*, 190.

<sup>125</sup> Hale, "What's So Moral About Moral Hazard?," 1.

moral hazard is the tendency of insured parties to assume risks that they would not otherwise assume.<sup>126</sup> This increased exposure to risk places a greater reliance on the federal government and the taxpayer for support.

Deductibles can apply to all insurance policies whether property, business continuity, business interruption, temporary facilities, or contents of a building.

Deductibles for property insurance are commonly a straight deductible or aggregate deductible. The straight deductible typically applies to each loss whereas the insured must pay a certain amount (the deductible) before the insurer is required to make a payment. The aggregate deductible is all losses are accumulated in a given period of time to satisfy the deductible amount. Once the aggregate deductible is met, the insurer is required to pay for all future losses in full, based on policy limits.<sup>127</sup>

Risk financing is a component of risk management that takes into account risk retention and insurance. The overall goal is provide a cost effective means of providing a payment after losses occur.<sup>128</sup> Risk retention is primarily the conscious decision to retain risk and deliberately retains all or part of that risk.<sup>129</sup> This is accomplished through balancing premiums and insurance deductibles.

## **B. THE CURRENT LAW, REGULATION, AND POLICY ON DEDUCTIBLES**

Existing law, regulation, and policy provide mixed guidance on the deductibles in FEMA's Public Assistance program. The law is detailed in Section 311 of the Stafford Act on the role of insurance under FEMA's Public Assistance program.<sup>130</sup> The Stafford act is silent on deductibles. However, Congress's intent through the Stafford Act assistance is intended to be supplemental in nature. The intent of Congress is that state and local governments protect

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<sup>126</sup> Hale, "What's so Moral about Moral Hazard?" 2.

<sup>127</sup> Rejda and McNamara, *Principles of Risk Management and Insurance*, 190.

<sup>128</sup> *Ibid.*, 13.

<sup>129</sup> *Ibid.*, 14.

<sup>130</sup> The Stafford Act, Section 311.



themselves by obtaining and maintaining insurance coverage to supplement or replace government assistance.<sup>131</sup> Insurance being the first source of funding for repair or replacement of a facility and federal disaster assistance supplements the shortfalls in presidentially declared disasters.

Regulation is provided by 44 CFR Sections § 206.252 and § 206.253 of the 44 Code of Federal Regulations for facilities damaged by flood and other than flood, respectively. FEMA's February 8 memo rescinded Disaster Assistance Fact Sheet 9580.3, which provided additional guidance on the eligibility of deductibles.<sup>132</sup> While the memo addressed and re-stated several issues involving insurance, the memo has rescinded prohibition on subsequent deductibles, which the fact sheet delineated. Both sections of regulations for flood and other than flood require FEMA to reduce the eligible costs by the amount of insurance proceeds.<sup>133</sup> Most would argue that insurance proceeds do not include the deductible, only the "check" provided by the insurance company. Therefore, the rescission of the fact sheet with respect to deductibles is consistent with law and regulation, except for blanket or pool arrangements. 44 CFR provides the guidance for "blanket, pool arrangements, or some combination of these options" as eligible costs will be reduced by the amount of eligible damage sustained on the previous disaster.<sup>134</sup> The amount of eligible damage would include the deductible from the previous event.

### **C. FACILITIES DAMAGED BY FLOOD**

For facilities damaged by flood, the regulation mandates the reduction of the maximum amount of insurance proceeds that would have been received if the buildings and its contents had been covered by a standard flood insurance

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<sup>131</sup> The Stafford Act, Section 101(b)(4).

<sup>132</sup> Deborah Ingram, "Disaster Assistance Fact Sheet 9580.3, Insurance Considerations for Applicants," Letter of February 8, 2013.

<sup>133</sup> 44CFR, § 206.252 and § 206.253.

<sup>134</sup> Ibid., § 206.253(b)(2).

policy.<sup>135</sup> The standard flood insurance policy available through the National Flood Insurance Program (NFIP) for non-residential properties is a maximum of \$500,000 for the building and \$500,000 for contents.<sup>136</sup> NFIP policies are available for properties and contents from a minimum of \$50,000 up to the maximum of \$500,000. The non-residential policy types are split according to the flood zones as listed in Table 7.<sup>137</sup>

Type Policy	Flood Zones	Minimum Policy Limit	Maximum Policy Limit	Standard Deductible*
Preferred Risk Policy	<b>ZONES B, C, X</b>	\$50,000/\$50,000	\$500,000/\$500,000	\$1,000
Standard Rated Policy	<b>ZONES B, C, X</b>	\$100,000/\$50,000	\$500,000/\$500,000	\$1,000
Standard Rated Policy	<b>ZONES A</b>	\$100,000/\$50,000	\$500,000/\$500,000	\$2,000
Standard Rated Policy	<b>ZONES V</b>	\$200,000/\$100,000	\$500,000/\$500,000	\$2,000

\* Applied separately to building and contents

Table 7. Non-residential flood insurance policy types (from FloodSmart.gov, [http://www.floodsmart.gov/floodsmart/pages/commercial\\_coverage/policy\\_rates.jsp](http://www.floodsmart.gov/floodsmart/pages/commercial_coverage/policy_rates.jsp))

The deductible is applied separately to a building and its contents, although both may be damaged in the same flood.<sup>138</sup> Optional deductibles are available up to \$50,000. However, for purposes of the regulation the standard deductible is \$1000 or \$2000.

The law and regulation highlights the maximum reduction of insurance proceeds for properties in a Special Flood Hazard Area (SFHA). The guidance does provide a grace period of one year to allow the facility owner to adjust to changes in the Special Flood Hazard Area. This grace period allows for flood

<sup>135</sup> 44CFR, § 206.252(a).

<sup>136</sup> National Flood Insurance Program, "Answers to Questions about the NFIP" (Washington, D.C.: FEMA F-084, March 2011), 18.

<sup>137</sup> No author, "Commercial Coverage: Policy Rates," last modified October 1, 2013, accessed October 19, 2013, [http://www.floodsmart.gov/floodsmart/pages/commercial\\_coverage/policy\\_rates.jsp](http://www.floodsmart.gov/floodsmart/pages/commercial_coverage/policy_rates.jsp).

<sup>138</sup> National Flood Insurance Program, "Answers to Questions About the NFIP," 20.

map revisions and allows some leeway for a facility that is affected by changes to a Special Flood Hazard Area. A SFHA is a high-risk area defined as any land that would be inundated by a flood having a 1-percent chance of occurring in a given year (also referred to as the base flood). The SFHA would be defined as Zone A, Zone AO, Zone AH, Zones A1–A30, Zone AE, Zone 99, Zone AR, Zone AR/AE, Zone AR/AH, Zone AR/AO, Zone AR/A1–A30, Zone AR/A, Zone V, Zone VE, and Zones V1–V30.<sup>139</sup>

The standard deductible is important, as the maximum standard flood insurance policy is the standard deductible on the maximum policy available. The insurance proceeds available would be the maximum policy available minus the standard deductible. In practice, the maximum insurance proceeds available are \$500,000 minus \$1,000 or \$2,000 for the building and the same, separately, for contents.

For buildings damaged by flood outside a SFHA, the insurance reduction will be the actual or anticipated insurance proceeds.<sup>140</sup>

In current practice, the standard deductible would be eligible for assistance in the first event and subsequent events for facilities damaged by flood perils.

#### **D. FACILITIES DAMAGED BY OTHER THAN FLOOD**

For facilities damaged by other than flood, the regulation leaves ambiguity in the implementation of policy with respect to deductibles. Section § 206.253 of the 44 Code of Federal Regulations is divided between blanket policies or pool arrangements and all other types of policies.

For blanket policies or an insurance pool arrangement, the deductible will be paid in the first disaster only. According to regulation, if the same facility is damaged in a subsequent event of a similar type, the eligible costs will be

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<sup>139</sup> National Flood Insurance Program, “Answers to Questions About the NFIP,” 30.

<sup>140</sup> Federal Emergency Management Agency, *Public Assistance Policy Digest*, 76.

reduced by the amount of eligible damage sustained on the previous disaster.<sup>141</sup> Therefore, for blanket or an insurance pool arrangement deductibles will only be reimbursed in the first event. In current practice, deductibles would be eligible in a subsequent event for non-blanket policies, non-pool arrangements, or some combination.

Deductibles for blanket policies are risk management decisions that should not hold the taxpayer financially responsible. Regulation provides unambiguous guidance on deductibles for blanket or pooled arrangements. Eligible damage, as defined in regulation, would include the deductible. § 206.253 (b) (2) is a critical component of the ineligibility of deductibles in current program implementation for the Public Assistance program. In a blanket, or pooled arrangement of insurance, the deductible, the insurance limit of liability for each structure, and the overall policy limit are critical components of risk management. The deductible is a key component of the facility owner's risk management or risk financing decisions.

## **E. CONSIDERATIONS FOR SUBSEQUENT DEDUCTIBLES**

For all other types of insurance policies, the eligible costs will be reduced by the insurance proceeds.<sup>142</sup> This segment of the regulation allows for reimbursement of deductibles in the first and all subsequent events.

In the case where the deductible is the same as the first event, some would agree that the event caused the need to pay for the second deductible and reimbursement of the second deductible is consistent with law and regulation. However, based on the fact that the insurance company has made a payment for an insurance claim to the facility owner, the insurer will likely raise the insurance premium at the end of the policy period. As a result, the facility owner has a decision to make with respect to the increased premium. The facility owner could (1) pay the increased premium; (2) negotiate an increased deductible in order to

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<sup>141</sup> 44 CFR, § 206.253(b)(2).

<sup>142</sup> Ibid., § 206.253(a).

minimize the premium increase or completely offset an increase in premium; (3) negotiate a lower policy limit to eliminate or limit a premium increase. From FEMA's prospective, the increased deductible in the subsequent event is an added risk to the Agency and taxpayer. While the increase in deductible may be a good business practice for the facility owner, the increase in deductible creates questions related to duplication of benefits and reasonableness for FEMA.

Similarly, deductibles for catastrophic events (earthquake, hurricane, and flood) are typically a percentage of the policy limit. The most common is 3% of the value of the building with 5% as the maximum. As in the previous example, the facility owner is not increasing his or her own risk in raising the deductible on the facility following a major disaster. The catastrophic event would likely trigger a major disaster declaration. Therefore, facility owners are not greatly increasing their own risk by raising the deductible following a first event as the federal government assumes the risk of the increased deductible. Thus, the facility owner is provided even more protection in the eligibility of the second deductible.

## **F. DEDUCTIBLES AND RISK MANAGEMENT**

Deductibles are a key component of risk financing, a component of risk management. The facility owner makes the decision on how much risk to retain in the deductible. The possibilities are endless. Depending on the situation, the facility owner can retain very little risk in a low deductible and an offsetting higher premium. For example, the retention of minimal risk is best employed for low frequency, high severity risks where facility owner may want to consider transferring as much risk as possible to another party. Conversely, the facility owner can retain a greater portion of risk with a higher deductible and a lower premium. Risk retention may be very appropriate for a high frequency, low severity risks where the potential losses are relatively small.<sup>143</sup>

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<sup>143</sup> Rejda and McNamara, *Principles of Risk Management and Insurance*, 14.

Another component of the analysis of deductibles is a self-insurance. Self-insurance is form of planned retention by which all or part of a given loss exposure is retained by the facility owner. Self-insurance is a method of reducing costs as the retained risk is self-funded. Additionally, the self-insurance benefit is the tailored fit for the facility owner. Within FEMA's Public Assistance program, only states can self-insure.<sup>144</sup>

A self-insured retention (SIR) offers a slightly different alternative in risk financing. If a facility owner decided to retain only a portion of the risk, this would be a SIR. The SIR would be a dollar limited retention of risk. As an example, the facility owner decided to retain \$25 million in risk and the SIR had a ceiling of \$25 million with a commercial policy for catastrophic events with losses that exceed the SIR limit. This type of risk financing greatly reduces costs while leaving the self-insured responsible for the retained risk.

As a point of clarity, the SIR is monetary amount of a loss that the policyholder must pay before its insurance applies.<sup>145</sup> A deductible is the amount of policy coverage that a policyholder must pay as a condition of receiving payment for a covered claim.<sup>146</sup>

## **G. CONCLUSION**

Deductibles are a key component of risk management in the protection of a facility and funding protection of losses to that facility. Deductible decisions are a component of risk retention by a facility owner. The balance of retained risk and the insurance premium is part of the overall risk financing of a facility, which includes the deductible and the protection of insurance.

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<sup>144</sup> The Stafford Act, Section 311 (c).

<sup>145</sup> New Appleman, *Insurance Law Practice Guide*, 2012, Matthew Bender & Company, a member of the LexisNexis Group, 31.06, 1.10.

<sup>146</sup> *Ibid.*

While not considered a deductible, self-insurance or a self-insured retention is the same decision-making process in the retention of risk. While the types of self-insurance may be cost effective, the insured has the responsibility for the retained risk, which may be all or part of the facility value.

FEMA's Public Assistance program currently reimburses applicants for a reasonable deductible from the first event and, in some cases, subsequent events. However, reasonable is not delineated and, in the complex world of risk management, reasonable may be getting harder to define with the many retained risk and self-insurance options.

Chapter IV will transition from deductibles to blanket or pool arrangements insurance policies. Very few jurisdictions have single policies to insure their facilities. Blanket and pool arrangements of insurance cover multiple structures and are more typical of the types of policies that a jurisdiction may have to insure their facilities. These types of policies, like deductibles, are another key component of an insurance protection and risk management.

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#### **IV. TYPES OF INSURANCE POLICIES: BLANKET POLICIES, INSURANCE POOL ARRANGEMENTS, SELF-INSURANCE, AND CATASTROPHE BONDS**

Types of insurance policies should be a straightforward issue. However, given the current regulations, the types of insurance policies can create debate over policy types. This chapter will address the different types of insurance policies from blanket policies, pool arrangements, and self-insurance as well as alternative noninsurance transfers of risk for both flood and other than flood hazards. Regulation, specifically § 206.253(b)(2), addresses blanket, pool arrangements or some combination as group. However, this chapter will address them separately in order to provide a more in-depth background on each type of policy.

Insurance policy types have a different connotation to the facility owner, to the Public Assistance program, and to the taxpayer. This chapter will also address the law and regulation as it pertains to each type of policy and then considerations for the facility owner and finally the taxpayer who does not have a voice in the decision but the most substantial liability.

##### **A. INSURANCE TERMS**

While there are volumes of terms used in the insurance industry. Only a couple terms are critical to the discussion at hand as it relates to insurance in FEMA's Public Assistance Program.

*General Property Insurance*—FEMA uses this term to describe the insurance that covers all perils but flood.<sup>147</sup>

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<sup>147</sup> Federal Emergency Management Agency, *Public Assistance Guide*, 2007, 120.

*Flood Insurance*—The Stafford Act includes specific provisions for insurance of facilities located in floodplains. Most property insurance does not cover damage from flood. A separate flood insurance policy must be purchased to obtain this coverage.<sup>148</sup>

A key component to property and casualty insurance policy is the type of claim the property owner would receive in the event of damage or loss. The method of valuation of insured property is typically actual cash value or replacement cost insurance.

*Replacement cost insurance*—Property insurance where the insured is indemnified on the basis of replacement cost of the facility with no deduction for depreciation.<sup>149</sup> The replacement cost is typically based on current construction costs to build or repair the facility.

*Actual Cash Value*—Value of the property at the time when damage or loss occurred, determined by subtracting depreciation of the facility from its replacement cost.<sup>150</sup>

## **B. BLANKET INSURANCE POLICY**

The term blanket policy is not defined in the Stafford Act or 44 CFR. Blanket insurance policy is defined in the Flood Insurance Manual, which also defines other policy types important to the discussion. Specifically, scheduled building policies are an important part of the definition of blanket policies and their distinctions.

*Blanket Insurance.* A single amount of insurance applying to more than 1 building and/or contents. Blanket insurance is not permitted under the NFIP.<sup>151</sup>

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<sup>148</sup> Federal Emergency Management Agency, *Public Assistance Guide*, 2007,120.

<sup>149</sup> Rejda and McNamara, “Principles of Risk Management and Insurance,” 673.

<sup>150</sup> *Ibid.*, 660.

<sup>151</sup> Flood Insurance Manual, National Flood Insurance Program, FEMA, May 2011, Definitions, 1.

*Scheduled Building Policy.* A policy that requires a specific amount of insurance to be designated for each building and its contents.<sup>152</sup>

*Couch on Insurance* offers a similar definition of a blanket policy -- a policy that "attaches to, and covers to its full amount, every item of property described in it."<sup>153</sup> In Illinois law, blanket coverage in a casualty and property insurance policy defines the upper limit of liability of the policy whereas a blanket limit applies to a loss at any location covered by a blanket.<sup>154</sup>

*Appleman's on Insurance* defines blanket policies as policies that cover all property owned by the insured and such policies may provide a blanket limit for all covered properties combined or include sub-limits that apply to specific properties.<sup>155</sup> The definition of policy limits is further defined a single policy limit that applies to more than one category of property, more than one location, or both.<sup>156</sup>

Conversely, a scheduled policy as a policy in which "each separately treated item of property is in effect covered by a separate contract of insurance and the amount recoverable with respect to a loss affecting such property is determined independently of other items of property."<sup>157</sup> This definition was a key factor in the court decisions that will be addressed on the subject of blanket and scheduled policies.

The International Risk Management Institute defines blanket policy as a single insurance policy that covers several different properties, shipments, or locations. A blanket limit is defined as a single limit of insurance that applies over more than one location or more than one category of property coverage, or both.

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<sup>152</sup> Flood Insurance Manual, 2011, 7.

<sup>153</sup> Lee R. Russ and Thomas F. Segalla, *Couch on Insurance*, Volume 12, 3D (West, December 2012), § 177.72.

<sup>154</sup> *Ibid.*

<sup>155</sup> New Appleman, *Insurance Law Practice Guide*, 2012, Matthew Bender & Company, a member of the LexisNexis Group, 31.06, 31.06[3][c].

<sup>156</sup> *Ibid.*, 47,10[4][d].

<sup>157</sup> Russ and Segalla, *Couch on Insurance*, § 175.90.

This is in contrast to specific or scheduled limits of insurance, which are separate limits that apply to each type of property at each location according to the International Risk Management Institute.

Three court cases are impactful in defining the differences in specific insurance policies and blanket insurance policies. These three court decisions build on the definitions addressed and have established precedence in insurance law.

**1. Vernon Fire and Casualty Insurance Company vs. Sharp (Columbus Wood Preserving Company)**

This case focuses on the key points surrounding two insurance policies that have a schedule of values insuring the components of the insured's property and contents. The Supreme Court of Indiana was asked to determine the limit of liability of the insurer when a blanket policy had a schedule of values. When damaged by fire, are the policy limits the schedule of values or the overall policy limit?

The Columbus Wood Preserving Company had two insurance policies with a limit of liability of \$31,250. A fire caused \$94,108 in itemized losses to the business. The itemized losses were derived from each line of property listed on the policy or the schedule of values. Even though the total loss was within the total value of the two policies, losses on some of the individual pieces of property exceeded the value assigned them in the policy schedules while other pieces of scheduled property suffered no damage. Consequently, the total value of the loss sustained exceeded the total stated value of those damaged or destroyed properties. The Court found:

"The plaintiff's losses exceeded the amount of the insurance provided under the two contracts, and under "blanket" policies he would have been entitled to reimbursement for the stated policy limits of \$31,250.00 upon each contract. However, these were not "blanket" policies but were "scheduled" policies, i.e., the property insured was separately scheduled and valued in the contracts. The liability of the insurers under such policies is limited as to each

scheduled item, and a portion applying to one item but unused may not be transferred to another item which was under-valued and thus underinsured.”<sup>158</sup>

The Court concluded that Sharp’s insured loss was a total of \$47,054.04 or \$23,527.02 under each policy.<sup>159</sup> In other words, the limit of the schedule of value of each line of property listed in the contract of insurance.

## **2. Anderson Mattress Company vs. First State Insurance Company**

This case focuses on the key points surrounding the meaning of blanket or specific coverage insurance policies.

Anderson Mattress Company (Anderson) submitted an application for blanket insurance coverage for their buildings, contents, and loss of business income to their insurance broker. In 1989, mattress companies were difficult to insure because of the flammable nature of the materials. First State Insurance Company (First State) responded to the submitted application and confusion existed as to the type of policy. Anderson applied for and received a blanket insurance policy, which the insurance broker confirmed. First State apparently rejected the blanket policy application and quoted a specific insurance policy. The policy was renewed a second year under the same circumstances.

In 1990, during the renewal policy period, fire destroyed much of the Anderson factory, attendant facilities, and caused a substantial business interruption. Anderson filed their claim with First State and expected to receive \$1,865,407 in insurance proceeds under the blanket policy. First State paid \$1,329,611 in insurance proceeds based on a specific insurance policy.

From the facts of the case, there was more than one issue in front of the Court. However, only the issue related to the type of insurance will be addressed in this research, not the five other issues involved.

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<sup>158</sup> Vernon Fire and Casualty Insurance Company vs. Sharp, No 349 NW 2<sup>nd</sup> 173 (1976), Rehearing September 3, 1976, Supreme Court of Indiana.

<sup>159</sup>Ibid.

First State makes the argument that the policy is unambiguously a specific insurance policy. The core of First State's argument is in citing 15 Couch on Insurance 2d 54:83 that a schedule of property values in an insurance policy renders the policy coverage specific and not a blanket.<sup>160</sup>

"A distinction must be made between a policy which speaks in terms of a lump sum obligation or value of the property and one which separately schedules different items of property. In the latter case, each separately treated item of property is in effect covered by a separate contract of insurance and the amount recoverable with respect to a loss affecting such property is determined independently of other items of property."<sup>161</sup>

Additionally, First State cited Vernon Fire and Casualty Co vs Sharp in defining blanket or specific insurance coverage and the policy limits associated with each type of policy.

The insurance broker argues that the policy is ambiguous in the language of the policy. Anderson Mattress did not present an argument regarding the type of policy, whether blanket or specific.

As the policy listed the specific properties with a limit of liability for each of the properties, the contents of those properties, and for the cost of business interruption, the Fifth District Court of Appeals of Indiana ruled that the policy was indeed a specific policy. In other words, the insurer's limit of liability was the limit of each scheduled item and any unused limits may not be transferred to another item which was undervalued or underinsured.<sup>162</sup>

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<sup>160</sup> Anderson Mattress Company vs. First State Insurance Company, No. 30A05-9205-CV-159, Submitted July 19, 1993, Court of Appeals of Indiana, Fifth District.

<sup>161</sup> Russ and Segalla, Couch on Insurance, § 175.90.

<sup>162</sup> Anderson Mattress Company vs.. First State Insurance Company, No. 30A05-9205-CV-159, Submitted July 19, 1993, Court of Appeals of Indiana, Fifth District.

### **3. Florida Insurance Guaranty Association vs. B.T of Sunrise Condominium Association, Inc.**

This case focuses on the key points surrounding the meaning of blanket insurance policies.

B.T. of Sunrise Condominium Association, Inc (Sunrise) had an insurance policy with Southern Family Insurance Company (SFIC) covering the seven buildings in the complex. The policy was valid during the subject incident period and each building was listed separately on the “Description of Premises” with a policy limit and insurance premium.<sup>163</sup> The policy limit was \$2,906,719 with a total premium of \$17,518 and a deductible of \$2,500 per building. Hurricane Wilma damaged all seven buildings on October 24, 2005. SFIC subsequently issued seven checks totaling \$268,994.54, and divided the insurance proceeds between the seven buildings, depending on the valuation of each building and the damage attributed to each building.

When SFIC became insolvent, the Florida Insurance Guaranty Association (FIGA) took over the obligations of SFIC in accordance with Florida statutes. Sunrise was not satisfied with the settlement paid by SFIC and requested supplemental payments from FIGA. FIGA tendered an additional \$299,900, which represented the statutory cap of \$300,000 that FIGA was required to pay on each covered claim, less the \$100 deductible. Since Sunrise had one policy, FIGA’s maintained that their obligation was a single \$300,000 limit of liability.

The District Court of Appeal of the State of Florida, Fourth District, ruled that FIGA had the same obligations as SFIC, the insolvent insurer, and FIGA’s responsibility the same as SFIC contractual obligations.<sup>164</sup> More importantly to the subject at hand, the Court found a difference between a policy that contains an “aggregate” value for several insured buildings, and a policy with separate

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<sup>163</sup> Florida Insurance Guaranty Association vs. B.T. of Sunrise Condominium Association, Inc, No. 4D09-5300, Submitted September 22, 2010, District Court of Appeal of the State of Florida, 4<sup>th</sup> District.

<sup>164</sup> Ibid.

schedules of each of the seven buildings.<sup>165</sup> Additionally, Sunrise could not transfer the limit of insurance coverage between one building to another building in order to offset under-valued or under insured assets. Under the SFIC policy, Sunrise would have been entitled to insurance coverage for all seven buildings up to the policy limit of \$2,906,719.<sup>166</sup>

The Court made the distinction that the SFIC policy provided separate contracts of insurance as the policy delineated separately scheduled buildings. The schedule of values made the coverage specific, not blanket.<sup>167</sup> Each building was covered separately on the declarations page of the policy, with a separate covered amount (policy limit), and separate premiums listed for each building therefore each of the seven claims should have its own statutory cap as listed on the "Description of Premises."<sup>168</sup>

To summarize, the three cases, all three rely on Couch on Insurance § 175.90 in determining blanket vs a scheduled policy.

"A distinction must be made between a policy which speaks in terms of a lump sum obligation or value of the property and one which separately schedules different items of property. In the latter case, each separately treated item of property is in effect covered by a separate contract of insurance and the amount recoverable with respect to a loss affecting such property is determined independently of other items of property."<sup>169</sup>

The three cases draw their conclusions from a policy with a schedule of values specific to each listed property or insured article. In *Florida Insurance Guaranty Association vs B.T of Sunrise Condominium Association, Inc.*, the property insurance policy is a separate contractual agreement with the insurance

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<sup>165</sup> Ibid.

<sup>166</sup> Ibid.

<sup>167</sup> Ibid.

<sup>168</sup> Ibid.

<sup>169</sup> Russ and Segalla, Couch on Insurance, § 175.90.



company on each of the properties. With the schedule of values, separate premiums, and segmented deductibles, the insurance policy is in fact seven separate contractual agreements.

In *Vernon Fire and Casualty Insurance Company vs Sharp (Columbus Wood Preserving Company)* and *Anderson Mattress Company vs First State Insurance Company*, the policies in question limit the liability of the insurer adhering to the schedule of values of each article insured by the policy. The limit the liability of the insurance company is by article insured, not the overall policy limit. In both these cases, the insured would have been better off with a blanket policy given the facts of the damage sustained by fire.

As a result, a definition between a blanket and a schedule of values could be defined by comparing the schedule of values and overall policy limit. The limit of liability of a blanket policy is less than the sum of the schedule of values for the facilities covered under the policy. A non-blanket policy would have an overall policy limit of liability equal to the schedule of values or, in essence, a separate contract of insurance of each insured item.

### **C. POOL ARRANGEMENT**

Although the definition of a blanket (and scheduled) policy is not defined in the Stafford Act or 44 CFR, the definition is defined in insurance law and insurance practice. In addition to blanket policies, 44 CFR § 206.253(b)(2) also addresses “pool arrangements or some combination of these options” in the regulation of insurance for other than flood perils. The context is an arrangement or combination that covers multiple buildings as this paragraph is the only location in the insurance section that addresses multiple facilities. However, the definition “pool arrangement” (or some combination of these options) is not well defined by the insurance industry or in law, regulation, or policy.

Similarly, *Appleman's on Insurance* does not define pool arrangement. However, risk pooling is defined as sharing risk and losses by averaging them together by employing the law of large numbers.<sup>170</sup> The more numbers averaged together, in a certain range, become more stable and predictable.

An additional definition of pooling is “spreading the losses incurred by the few over the entire group, so that in the process, average loss is substituted of actual loss.”<sup>171</sup> Again, the law of large numbers applies to a group in pooling potential losses across the group in its entirety.

The International Risk Management Institute defines risk pool as “multiple subjects of insurance insured by a single insurer where, to avoid risk concentration and improve risk distribution, different combinations of exposures, perils, and hazards will be underwritten.”

Pool arrangement is defined in the Disaster Operational Legal Reference as “agreement among a group of entities to pool their resources to jointly fund a deductible for the group of properties they own.”<sup>172</sup> This type arrangement is a group of insured's pooling risk under one insurance company for the mutual funding of the deductible and insurance coverage spreading the risk among all the entities pooled in coverage.

A pool arrangement, conversely, could be a high risk insured covered by multiple insurance companies, each with a percentage of the limit of liability. This is the reverse of the previous examples where several insurance companies ensure a percentage of one high risk facility. In essence, this means pooling the potential losses across the pool of insurance companies.

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<sup>170</sup> New Appleman, *Insurance Law Practice Guide*, 2012, Matthew Bender & Company, a member of the LexisNexis Group, 31.06, 1.05.

<sup>171</sup> Rejda and McNamara, *Principles of Risk Management and Insurance*, 672.

<sup>172</sup> Federal Emergency Management Agency, *Disaster Operations Legal Reference* (Washington, D.C.: FEMA, June 1, 2013), 5–81.

One example of a pool arrangement provided by the federal government would be the insurance provided by the Price Anderson Act. The Price Anderson Act was passed in 1957 in order to ensure that adequate funds would be available to satisfy liability claims of members of the public for personal injury and property damage in the event of a nuclear accident involving a commercial power plant.<sup>173</sup> Plant owners pay a premium to private insurance companies for \$375 million of liability coverage for each of their reactors. The private insurance is in essence a “pool arrangement” as the American Nuclear Insurers provides the insurance coverage to a high risk industry via multiple property and casualty insurers throughout the world.<sup>174</sup> In the event of a nuclear accident that exceeds the private insurance coverage of \$375 million in damages, each plant owner would be assessed a prorated share up to \$111.9 million.<sup>175</sup> This second tier coverage is approximately \$11.6 billion, which is the maximum assessment to all 104 reactors in the US. The Act provides for prioritization of funds by the federal district court when 15% of the funds have been expended and commits Congress to determine whether additional funds are required if the second tier is depleted. Since the enactment of the Price Anderson, the Act has paid approximately \$151 million in claims.<sup>176</sup>

Another example of a pool arrangement is being explored by the Australia in a systematic method to develop a national road pool of insurance. The pool is a national approach to better manage the costs of damage to road infrastructure caused by natural disasters.<sup>177</sup> The pool arrangement is in conceptual discussions in order minimize the burden of disaster assistance to any one entity and appropriately encourage risk management of road assets. Under the pool

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<sup>173</sup> U.S. Nuclear Regulatory Commission, “Nuclear Insurance and Disaster Relief Funds,” Fact Sheet, June 2011.

<sup>174</sup> Ibid.

<sup>175</sup> Ibid.

<sup>176</sup> Ibid.

<sup>177</sup> Department of Finance and Deregulation, “Managing the Cost of Damage to Road Infrastructure Caused by Natural Disaster—National Pool Approach,” August 2012, 3.

model, all jurisdictions would share the direct costs associated with road damage.<sup>178</sup> The cost sharing could be proportional across all jurisdictions and the Commonwealth or non-proportional in a layered approach to the pool arrangement. The proportional method balances revenue base of each jurisdiction and relative exposure to natural hazard risk of each jurisdiction. The result is a pre-determined proportion of the costs of road damage in a jurisdiction, regardless of where the damages occur.<sup>179</sup> The pre-determined percentage of contribution would undoubtedly be politically charged but would balance risk and revenue across the country. In evaluating the pool model for this method the Commonwealth accounted for the largest percentage of participation with the other jurisdictions sharing the remainder. The non-proportional method would be a layered approach, whereas the jurisdictions would be required to have a specified amount of insurance in the first layer of coverage. The second layer would be a cost sharing provision across all jurisdictions. The Commonwealth would provide the final layer. Many variables are still associated with the concept. To be effective, most, if not all, jurisdictions would have to participate in order to average risk using the law of large numbers. Funding of the pool arrangement could be in advance or after the fact in reimbursement and management of the program are all important considerations being developed in the exploration of the concept.

In the 44 CFR, the intent of the “pool arrangement” section of regulation is to address the applicant’s ability to reduce the high cost of insurance. Applicants can insure multiple damaged facilities in a single consortium of insurance. The benefit to the applicant is to limit insurance costs into a policy that groups the multiple insured’s facilities in a pool of insurance. As a result, the insured entities create a risk pool to manage the overall risk of facilities and reduce insurance costs.

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<sup>178</sup> Department of Finance and Deregulation, “Managing the Cost of Damage to Road Infrastructure Caused by Natural Disaster—National Pool Approach,” 4.

<sup>179</sup> Ibid., 5.

The definition of pool arrangement was better defined in the explanation when the interim rule was published on December 11, 1991.<sup>180</sup> The FRN made clear that because of deductibles, an insurance pool arrangement, a blanket policy covering all their facilities, or some combination of these options, may not fully cover the damaged facility in all future cases. However, it may be the most efficient arrangement when considered from a risk management viewpoint.<sup>181</sup> As a result, a blanket, pool arrangement, or some combination of these options may be accepted for other than flood damages. However, if the same facility is damaged in a similar future disaster, eligible costs will be reduced by the amount of eligible sustained damage in the previous disaster since the amount should have been covered by insurance.<sup>182</sup>

The distinction is somewhat easy to draw between a blanket and schedule of values policy. The definition between a “pool arrangement” and a blanket policy is less defined. However, the interim rule as posted in December 11, 1991 provides the most clarity and context of the regulation in providing cost efficiencies to the insured. Broadly, a pool arrangement is risk pool which can be defined as an agreement among a group of entities to pool their resources to jointly fund a deductible for the group of properties they own.<sup>183</sup> The interim rule allows facility owners to pool insurance coverage either in a blanket policy or a pool arrangement in order to reduce premium costs, but not at the taxpayer expense.

#### **D. OR SOME COMBINATION OF THESE OPTIONS**

“Some combination of these options” is difficult if not impossible to define. The disparity between a blanket policy and risk pool of insurance is a wide range of insurance coverage that includes insurance proprietary policy, tailored

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<sup>180</sup> Federal Register, 56 FR 65558, Disaster Assistance; Subpart I—Public Assistance Insurance requirements (December 11, 1991) (C).

<sup>181</sup> Ibid.

<sup>182</sup> Ibid.

<sup>183</sup> Federal Emergency Management Agency, *Disaster Operations Legal Reference*, 5–81.

solutions for facility owners in order to reduce insurance costs, specifically deductible costs. The Federal Register Notice in 1991 provides the best guidance on intent, which is to not limit the insurance options of the insured while protecting the taxpayer's investment in the damaged facility. Again, facility owners may pool insurance coverage in many structures of insurance in order to better manage risk while balancing insurance costs, but not at the taxpayer expense.

## **E. SELF-INSURANCE**

Self-insurance can be best described as a retention program in which the facility owner self-funds or pays part or all of the losses.<sup>184</sup> The self-insurance decision is making the decision to retain or finance some or all its risks.<sup>185</sup> Self-Insurance decisions should be based on: (1) Foreseeable loss scenarios; (2) Frequency and severity of those loss scenarios; (3) Pricing and availability of insurance products to cover such risks; and (4) Whether the facility owner can and should retain and finance the potential risks against losses.<sup>186</sup>

In accordance with section 311(c) of the Stafford Act and the Flood Disaster Protection Act of 1973, only a state may act as a self-insurer.<sup>187</sup> While a distinction exists between flood and other than flood for a state electing to act as a self-insurer, the Stafford Act and the Flood Disaster Protection Act of 1973 both authorize the election. For other than flood, the Stafford Act authorizes the state to make an election to act as a self-insurer for any or all state facilities.<sup>188</sup> The requirement for the state is to make the election in writing at the time of assistance, or subsequently, and be accompanied by a plan for self-insurance

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<sup>184</sup> Rejda and McNamara, "Principles of Risk Management and Insurance," 674.

<sup>185</sup> New Appleman, *Insurance Law Practice Guide*, 2012, Matthew Bender & Company, a member of the LexisNexis Group, 31.06, 1.04.

<sup>186</sup> *Ibid.*

<sup>187</sup> The Stafford Act, Section 311(c) and the Flood Disaster Protection Act of 1973, Public Law 93-234.

<sup>188</sup> The Stafford Act, Section 311.

which is satisfactory to the President.<sup>189</sup> The Stafford Act also delineates that a self-insurer is not eligible for assistance for any property, which has previously received assistance under the Stafford Act to the extent that insurance for such property or part thereof would have been reasonably available.

The fact sheet rescinded in February 2013 did provide amplifying guidance in the self-insurance election. The fact sheet addressed that the self-insurance is only available for states and the guidance required the State to submit an established plan of self-insurance to be approved by FEMA's Assistant Administrator of the Disaster Assistance Directorate.<sup>190</sup>

For flood, the Flood Disaster Protection Act of 1973 provides the authority of the state to self-insure.<sup>191</sup> The standards established in 44 CFR §75.11 must be followed for flood disasters in the development of state self-insurance plans. These standards also serve as the model for non-flood disaster self-insurance plans.<sup>192</sup> The guidance set forth in 44 CFR §75.11 addresses obtain and maintain requirements for all state owned facilities covered under the self-insurance plan.<sup>193</sup> The regulation does provide guidance on the requirements in a self-insurance plan:<sup>194</sup>

- Formal policy or plan of self-insurance created by statute or regulation.
- Specify hazards covered by self-insurance plan expressly include flood and flood-related hazards, which are covered under a Standard Flood Insurance Policy.
- Specify coverage equal to that, which would otherwise be available under a Standard Flood Insurance Policy.

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<sup>189</sup> The Stafford Act, Section 311.

<sup>190</sup> Deborah Ingram, "Disaster Assistance Fact Sheet 9580.3, Insurance Considerations for Applicants," Letter of February 8, 2013.

<sup>191</sup> The National Flood Insurance Act of 1968, as amend, and the Flood Disaster Protection Act of 1973, as amended, August 1997, 42 U.S.C. 4012a(c)(1).

<sup>192</sup> Federal Emergency Management Agency, Disaster Assistance Policy 9580.3, May 2008. (Rescinded February 2013).

<sup>193</sup> 44 CFR, § 75.1.

<sup>194</sup> Ibid., § 75.11.

- Consist of a self-insurance fund, or a commercial policy of insurance or re-insurance, for which provision is made in statute or regulation and that is funded by periodic premiums or charges.
- Provide for the maintaining and updating by a designated State official or agency not less frequently than annually of an inventory of all state-owned structures and contents in a SFHA.
- Provide the flood loss experience based upon incurred losses for a period of not less than 5 years immediately preceding application for exemption, and certify that such historical information shall be maintained and updated.
- Include a certified copy of the flood plain management regulations set forth standards for state-owned properties within a SFHA.
- The Federal Insurance Administrator shall determine the adequacy of the insurance provisions whether they are based on available funds, an enforceable commitment of funds, commercial insurance, or some combination.

The state's burden is to establish that its self-insurance plan equals or exceeds FEMA's regulatory standards.<sup>195</sup> The Federal Insurance Administrator has the final review and approval of the self-insurance plan and may return the plan in order to obtain more information as to the adequacy of the plan.

## **F. WRITE-YOUR-OWN FLOOD INSURANCE**

Individual private sector property insurance companies or other insurers, such as public entity risk sharing organizations may offer flood insurance coverage under the program to eligible applicants.<sup>196</sup> Such Write-Your-Own (WYO) companies may offer existing policyholders flood insurance under their own property business lines of insurance. WYO companies may sell flood insurance coverage in states where they are authorized to conduct property insurance business. Other WYO insurers may offer flood insurance coverage to their pool members under their own property business lines of coverage, pursuant to their customary business practices.

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<sup>195</sup> 44 CFR, § 75.3.

<sup>196</sup> Ibid., § 62.23(a).



WYO companies can provide insurance of any amount within the maximum limits of the specific coverage of a NFIP policy and shall follow all terms and conditions of a Standard Flood Insurance Policy.<sup>197</sup> Additionally, the flood insurance coverage will be issued on a separate policy form and will not be added, by endorsement, to the company's other property insurance forms.<sup>198</sup>

## **G. CATASTROPHE BONDS**

An expanding type of alternative insurance protection includes Insurance Linked Securities (ILS) such as catastrophe bonds. These securities are a mechanism to transfer risk from one party to the capital markets. In 2011, over \$4.1 billion of catastrophe bonds were issued.<sup>199</sup> Today, there is over \$19 billion of outstanding securities as compared to under \$2 billion of outstanding securities in 2000. This is a growing market has been dominated by insurance companies issuing capital market securities to an investor base that includes hedge funds, other insurance companies, and high yield investors.

Catastrophe bonds are another mechanism to manage risk by transferring the explicit risk, defined in the security exhibits, from one party to another. The investor is essentially selling catastrophic insurance to the catastrophe bond seller. While the seller of a catastrophe bond has historically been insurance and reinsurance companies, governments are entering the capital markets as well. In February 2001, the California Earthquake Authority issued \$100 million of catastrophe bonds to transfer earthquake risk to the capital markets. The California Earthquake Authority is a publicly managed, largely privately funded entity established by the California Legislature in 1996. Insurance companies can offer residential property insurance in California through their own privately funded earthquake insurance product or they can be a participating insurance company through the California Earthquake Authority. Since February 2001, the

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<sup>197</sup> 44 CFR, § 62.23(c)

<sup>198</sup> Ibid., § 62.23(6).

<sup>199</sup> AIR Worldwide, "So You Want to Issue a Cat Bond," <http://www.air-worldwide.com/Publications/AIR-Currents/So-You-Want-to-Issue-a-Cat-Bond/>.

California Earthquake Authority has issued \$600 million of catastrophe bonds through three separate tranches in July 2012, January 2012, and August 2011. Figure 1 depicts the attachment and exhaustion points for each tranche as well as the credit ratings, coupon that floats off of one year U.S. treasuries, and amount of catastrophe bonds issued.

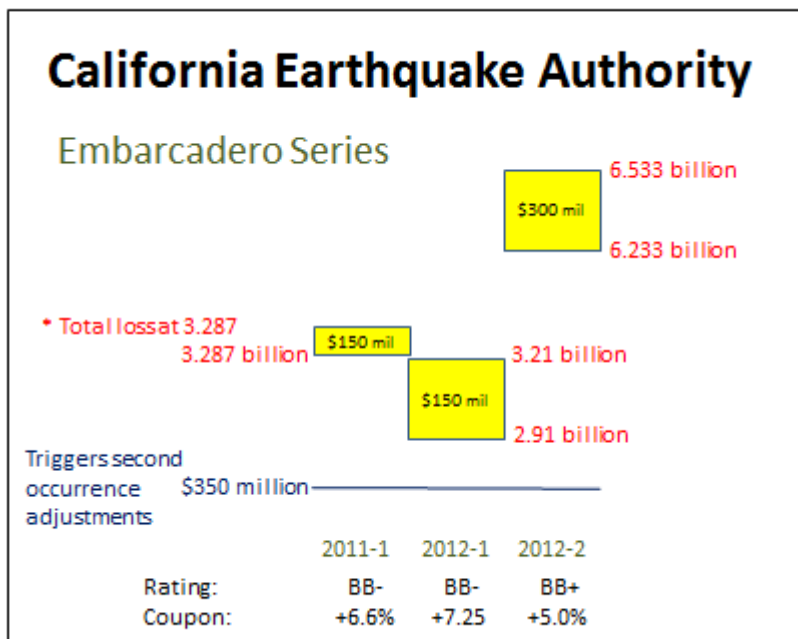


Figure 1. California Earthquake Authority – Embarcadero Series (from Embarcadero Re Ltd. Series 2012-II Class A Principal At-Risk Variable-Rate Notes Prospectus, Standard and Poors Rating Service, July 31, 2012)

The New York Transit Authority sold \$200 million in catastrophe bonds in July 2013 to cover the costs of storm surge damage from a future storm or hurricane. The capital markets transaction was upsized from the planned issue size of \$125 million and the interest rate was priced lower than expected due to the high demand of the security. Louisiana Citizens Property Insurance Corporation has also issued catastrophe bonds in April 2012 and May 2013 in addition to having posted a request for proposal for an additional tranche of bonds. The two previously issued tranches were \$125 million and \$140 million, respectively.

Catastrophe bonds are based on a trigger point which could be for indemnity, industry loss, or a specific parametric.<sup>200</sup> The structure of the bond will further define the probability of attachment, where the bond would suffer some losses, or probability of exhaustion, where the bond will suffer a complete loss. The investor would receive a coupon, or interest payment, in exchange for the investment of principle. The credit ratings of these bonds typically demand a higher interest rate in order to attract those investors. Some of the attractiveness of catastrophe bonds to hedge funds and pension funds is the uncorrelated risks to the financial markets. The seller of the catastrophe bond pays the interest rate on the coupon in exchange for the transfer of risk to the investor. If a trigger event occurs during the life span of the bond, the seller would receive all or part of the principle as payment on the loss. The attachment point and exhaustion point are clearly defined in the security prospectus where the bond begins to suffer losses to the point of complete loss. If a trigger event does not occur prior to maturity of the bond, the principle would be returned to the investor at the maturity of the bond in addition to receiving the periodic interest payments for the investment.

The trigger points for a catastrophic bond have several unique characteristics.<sup>201</sup>

- Indemnity—The trigger event is actual loss by the sponsoring insurer for a specific time period. For example, \$100 million in excess of \$300 million from April 1, 2013 to March 31, 2015 would trigger attachment at \$300 million and exhaustion point, or default of the bond, at \$400 million.
- Industry Loss—Trigger event is an industry loss provided by a firm that would make insurance loss estimates as a primary business. The industry loss trigger points are more transparent than indemnity transactions. While the trigger event is defined by industry models the attachment points and exhaustion points would be similar to the previous example.

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<sup>200</sup> AIR Worldwide, "So You Want to Issue a Cat Bond," 1.

<sup>201</sup> Risk Management Solutions, "Cat Bonds Demystified—RMS Guide to the Asset Class," [https://support.rms.com/publications/Cat\\_Bonds\\_Demystified.pdf](https://support.rms.com/publications/Cat_Bonds_Demystified.pdf).

- Parametric—Trigger event of a physical characteristic of a catastrophe event. For example, a hurricane's maximum wind speed and landfall location could be a trigger event. Or the case of the New York Transit Authority, the trigger event is storm surge levels during a named storm at five specific points.

Catastrophic bonds are issued under guidelines for private investments. As such, the trigger points can be structured to meet the needs of the sponsor of the security and the securities are issued in a safe harbor from typical Security and Exchange Commission registration requirements when meeting issuance minimums and sold to qualified investors. Therefore, trigger points including hybrid trigger points, modeled loss, or multiple event approach are certainly possible to meet the needs of the issuer.

Figure 2 is an example of an Indemnity catastrophic bond for \$100 million in excess of \$300 million. The example bond is hypothetically issued in 2012 with a maturity of 2015 and a coupon of Treasury Money Market Index + 10% which is paid quarterly.

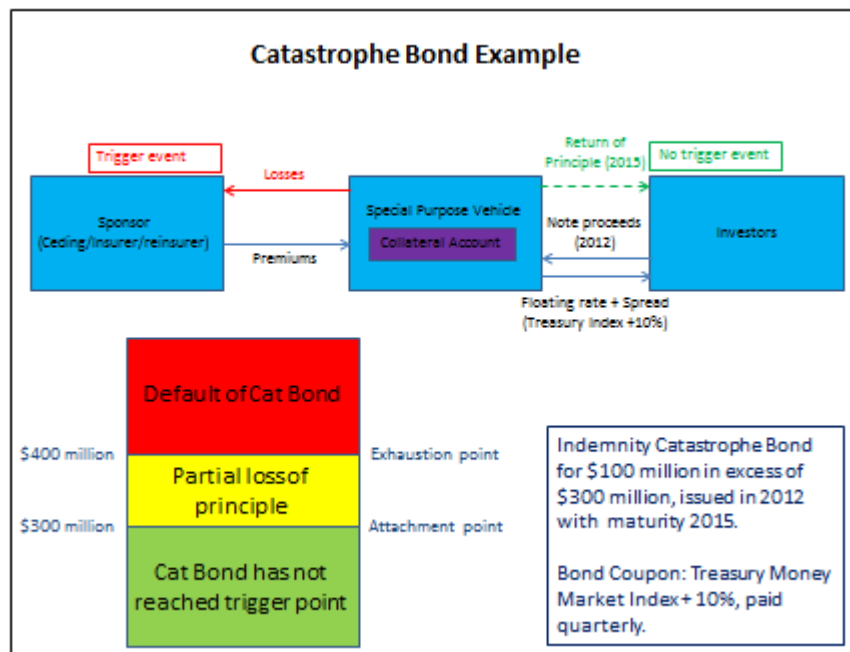


Figure 2. Catastrophic bond example (from Risk Management Solutions, "Cat Bonds Demystified—RMS Guide to the Asset Class," 2012 and AIR Currents, "So You Want to Issue a Cat Bond," February 2012)

Issuance of catastrophe bonds in the capital markets has been increasing since the markets inception in 1997. This alternative channel of risk management will continue to grow as long as investors have an appetite for such risk, the lack of correlation to other markets, and higher interest payments. FEMA must understand the implications the catastrophe bond structure in order to implement the Public Assistance program and in order to prevent a duplication of benefits.

## **H. CONCLUSION**

Facility owners have many decisions to make as to the types of insurance policies that will best protect their facilities in event of the unexpected. For states, the most basic decision is to whether to purchase insurance or elect to self-insure and retain financial potential risk themselves, or enter the capital markets in the issuance of catastrophe bonds.

The election to self-insure requires notification to the President, as delegated to FEMA, for review and approval of the self-insurance plan. The Federal Insurance Administrator has the final review and approval of the self-insurance plan for flood hazards, as addressed in the 44 CFR. For other than flood hazards, the state must declare its election to self-insure in writing at the time of acceptance of assistance, or subsequently, and submit an established plan of self-insurance with supporting documentation for approval to FEMA's Assistant Administrator for Recovery. Therefore, for flood or other than flood hazards, states must make an election to self-insure and submit a plan for approval.

The commercial property industry is immense and has given rise to a wide variety of specialized options for facility owners.<sup>202</sup> These options are specialized, proprietary in some cases, and innovative in providing tailored

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<sup>202</sup> New Appleman, *Insurance Law Practice Guide*, 2012, Matthew Bender & Company, a member of the LexisNexis Group, 31.06, § 41.01(2)(a)(i).

insurance coverage to facility owners. Law and regulation must be broad enough to adequately address past, present, and future insurance needs for both flood and other than flood hazards.

For flood, insurance requirements can be satisfied through three options. One, insurance policies purchased through the National Flood Insurance program. Two, policies purchased through the Write Your Own program, which follow all terms and conditions of a Standard Flood Insurance Policy. As a third option, states may elect to self-insure, which may include some commercially purchased insurance as a component of that coverage. As previously addressed, the election to self-insure requires review and approval of the plan.

For other than flood, regulations addresses blanket insurance policy covering all their facilities, an insurance pool arrangement, or some combination of these options. Policies that cover multiple facilities can be defined as blanket policies, which are defined in insurance law. However, an insurance pool arrangement is not defined in the insurance industry but logically addresses all insurance policies that form a risk pool of coverage across multiple facilities. The regulation intent appears to provide an option for facility owners to reduce cost and allow options in efficient insurance arrangements from a risk management viewpoint. Conversely, the option to pool all facilities may not fully cover the previous deductible of the damaged facility. The intent of the regulation appears to offer the facility owner options, while protecting the taxpayer.

Chapter V will transition from types of insurance policies to obtain and maintain requirements. These requirements are a condition of a previous Public Assistance grant where the facility received assistance for eligible damages. The timing of the requirement is not clear in regulation, although the requirement is critical. as the obtain and maintain requirement is a key component in protecting the taxpayer's investment in the repair, restoration, reconstructing, or replacement of a facility.

## **V. OBTAIN AND MAINTAIN**

The obtain and maintain requirement placed on a facility as a result of previous grant involves the requirement of insurance, the reimbursement of deductibles, and the Insurance Commissioner's Certification. This chapter will address those topics as related to the obtain and maintain requirement as well as the effects on future grants if the obtain and maintain requirement is not satisfied.

Seemingly a simple topic, obtain and maintain requirements involve many intricate details. This chapter will begin to tie together the importance of key elements of FEMA's insurance and the relation to the Public Assistance program. The first is the requirement to obtain and maintain insurance as a condition of reimbursement through the Public Assistance program.<sup>203</sup> The second is the prohibition of a duplication of disaster assistance benefits from any source, including insurance.<sup>204</sup> The third is the deductions from grant funding for uninsured facilities located in a SFHA.<sup>205</sup>

### **A. THE LAW AND REGULATION ON OBTAIN AND MAINTAIN REQUIREMENTS**

Section 311 of the Stafford Act requires the facility owner who receives assistance to repair, replace, or restore a damaged facility to obtain and maintain insurance on the damaged facility whereas the federal government provided a grant in order to protect against future loss to such property.<sup>206</sup> The insurance must be at least the amount of eligible disaster assistance including the cost for any hazard mitigation measures. However, the President will not require greater types and extent of insurance than are certified to him as reasonable by the appropriate State Insurance Commissioner responsible for regulation of such

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<sup>203</sup> The Stafford Act, Section 311.

<sup>204</sup> *Ibid.*, 312.

<sup>205</sup> *Ibid.*, 406.

<sup>206</sup> *Ibid.*, 311.

insurance.<sup>207</sup> A facility owner may not receive assistance for any property for which the facility owner has previously received disaster assistance unless all insurance has been obtained and maintained with respect to such property.<sup>208</sup>

Sections § 206.252 and § 206.253 of the 44 Code of Federal Regulations further places a requirement on the facility owner to obtain and maintain such types and amounts of insurance as are reasonable to protect against a future loss to the property from the types of the hazard which caused the major disaster.<sup>209</sup> The two sections address the insurance requirements for flood and other than flood, respectively.

For flood hazards, an insurable building, which is located in the Special Flood Hazard Area (SFHA) for greater than one year, shall be reduced pursuant to section 406 of the Stafford Act. The amount of the reduction shall be the maximum amount of insurance proceeds which would have been received had the building and its contents been fully covered by a standard flood insurance policy.<sup>210</sup> The regulation also requires the insurance requirement, in the amount of eligible disaster assistance, be obtained and maintained as a condition of receiving the grant. The obtain and maintain requirement for the past grant is a condition to receiving future disaster assistance under the Stafford Act. This requirement also applies to insurable damaged facilities located outside a SFHA when insurance is reasonably available, adequate, and necessary.<sup>211</sup>

For other than flood perils, the regulation addresses eligible damage instead of eligible assistance, which are treated as synonymous terms. The obtain and maintain requirement is a condition of the grant and insurance must be obtained and maintained in the amount of eligible damage that was incurred

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<sup>207</sup> The Stafford Act, Section 311.

<sup>208</sup> Ibid.

<sup>209</sup> 44CFR, § 206.252 and § 206.253.

<sup>210</sup> Ibid., § 206.252(a).

<sup>211</sup> Ibid., § 206.252(d).



to the damaged facility as a result of the major disaster.<sup>212</sup> In practice, the eligible assistance is treated the same as eligible damage. The requirement of obtaining and maintaining insurance to protect the federal investment is, again, a condition of the grant.

## **B. OBTAIN AND MAINTAIN EFFECT ON PUBLIC ASSISTANCE GRANTS**

Facility owners are required to obtain and maintain insurance if they have received assistance to repair, replace, or restore damaged facilities. The failure to satisfy these requirements will have a significant impact on the effect of Public Assistance grants. Disaster assistance can be provided for future declared events for eligible damages that exceed the insurance requirement. An exception to this requirement is a certification by the State's Insurance Commissioner that the required insurance is not reasonably adequate and available.

The requirement to obtain and maintain insurance varies slightly between the location of the facility and the type of peril that caused the damage. Damages from other than flood perils are treated slightly different than damages from flood perils in a SFHA, and flood perils outside of a SFHA. Each of these scenarios have nuances in the requirement to obtain and maintain insurance as a result of disaster assistance provided to a facility owner as a condition of the grant.

For other than flood perils, the obtain and maintain insurance requirement is based on the **eligible damage that was incurred** to the damaged facility as a result of the major disaster. If the obtain and maintain is not satisfied, the assistance provided in the first grant would be de-obligated as the assistance provided is based on the condition of the obtain and maintain requirement. Additionally, no assistance will be provided as a result of the current major

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<sup>212</sup> 44CFR, § 206.253(b)(1).

disaster unless all insurance required as condition of the previous grant has been satisfied.

For flood perils in a SFHA, the obtain and maintain requirement is **in the amount of eligible disaster assistance**, as a condition of receiving federal assistance that may be available. Again, if the obtain and maintain is not satisfied, the assistance provided in the first grant would be de-obligated as the assistance provided is based on the condition of the obtain and maintain requirement.

For flood perils outside a SFHA, the only distinction from a facility in a SFHA is the obtain and maintain requirement also applies to insurable damaged facilities when insurance is **reasonably available, adequate, and necessary**. Otherwise, the requirements are the same as facilities located inside a SFHA. An Insurance Commissioner Certification for an obtain and maintain requirement for this situations will be addressed in the next section of this chapter.

The only exception for all three scenarios is the obtain and maintain requirement are waived when eligible costs for an insurable facility does not exceed \$5,000.<sup>213</sup> As the interim rule on insurance, described on the Federal Register, the cost of tracking obtain and maintain requirements less than \$5,000 is not cost effective.<sup>214</sup>

The grantee has the lead responsibility for ensuring that the insurance requirement for insurable facilities and have received eligible disaster assistance has been obtained and maintained.<sup>215</sup> A grantee can be a state government or Tribal government who elects to work directly with the federal government.

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<sup>213</sup> 44CFR, § 206.252(d) and 44CFR, § 206.253(d).

<sup>214</sup> Federal Register, 56 FR 65558, "Disaster Assistance; Subpart I – Public Assistance Insurance requirements" (C).

<sup>215</sup> Federal Emergency Management Agency, DAP 9580.2, "Insurance Responsibilities for Field Personnel" (June 4, 2007).

### **C. INSURANCE COMMISSIONER’S CERTIFICATION**

The authority of the State Insurance Commissioner is well defined in the Stafford Act, as the President shall not require greater types and extent of insurance than are certified to him as reasonable by the appropriate State Insurance Commissioner responsible for regulation for such insurance.<sup>216</sup> As such, FEMA cannot require insurance beyond the type and extent of insurance that the State Insurance Commissioner certifies as reasonable. The complexity in law differs between other than flood and flood perils.

For a facility with disaster related damages in a declared event under Section 406 of the Stafford Act for other than flood, the State Insurance Commissioner, responsible for such regulation of insurance, may certify the types and extent of insurance that are reasonably available. States are responsible for the regulation of insurance and this responsibility is typically delegated to the State Insurance Commissioner. Consequently, the State Insurance Commissioner could certify that insurance is not reasonably available and, therefore, reduce the requirement to obtain and maintain insurance on the damaged facility in order to protect against a future loss to such property.

The Insurance Commissioner’s certification is applied differently for facilities damaged by flood perils. States do not regulate the National Flood Insurance Program (NFIP). Therefore, the State Insurance Commissioner is not “responsible for the regulation of” the NFIP and may not certify that NFIP is not reasonably available.<sup>217</sup> Consequently, the authority granted the Commissioner in Section 311 of the Stafford Act does not apply to insurance available under the NFIP. This limitation would negate the Insurance Commissioner’s ability to certify, as reasonable, eligible damages less than the NFIP policy limit of \$500,000 for the building and \$500,000 for contents.

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<sup>216</sup> The Stafford Act, Section 311.

<sup>217</sup> Federal Emergency Management Agency, *Disaster Operations Legal Reference*, 5–78.

The National Flood Insurance Act of 1968 (Public Law 90-448, August 1, 1968) was enacted to provide previously unavailable flood insurance protection to property owners in flood-prone areas.<sup>218</sup> The Flood Disaster Protection Act of 1973 (Public Law 93-234, December 31, 1973) requires the purchase of flood insurance, as a condition of receiving any form of federally-related financial assistance for acquisition or construction purposes with respect to insurable buildings and mobile homes within an identified Special Flood Hazard Area that is located within any community participating in the program.<sup>219</sup>

NFIP status as federal program is well defined in law. In *West v. Harris*, the U.S. Court of Appeals for the 5<sup>th</sup> Circuit has ruled that since the NFIP "...is a child of Congress, conceived to achieve policies which are national in scope, and since the federal government participates extensively in the program both in a supervisory capacity and financially, it is clear that the interest in uniformity of decision present in this case mandates the application of federal law."<sup>220</sup> In *McGair v. American Bankers*, the U.S. Court of Appeals for the 1<sup>st</sup> Circuit found that "insurance policies issued pursuant to the National Flood Insurance Program are a matter of federal law."<sup>221</sup> In *Jacobson v. Metropolitan Property*, the U.S. Court of Appeals for the 2<sup>nd</sup> Circuit found that all disputes arising from the handling of any claim under a NFIP policy are "governed exclusively by the flood insurance regulations issued by FEMA, the National Flood Insurance Act of 1968, as amended, and federal common law."<sup>222</sup>

NFIP policies, as a matter of federal law, have also been supported in second appeals by applicants to FEMA. The second appeal by Texas Parks and

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<sup>218</sup> 44 CFR § 59.2(a).

<sup>219</sup> 44 CFR § 59.2(a).

<sup>220</sup> United States Court of Appeals, Fifth Circuit, *West vs. Harris*, 573 F.2d 873 (1978), May 26, 1978, Rehearing Denied July 28, 1978.

<sup>221</sup> United States Court of Appeals, First Circuit, *McGair vs. American Bankers*, 693 F.3d 94 (2012), September 4, 2012.

<sup>222</sup> United States Court of Appeals, Second Circuit, *Jacobson vs. Metropolitan Property & Casualty Insurance Company*, 672 F.3d 171 (2012), March 6, 2012.

Wildlife Department pertained to the Texas Commissioner of Insurance's certification that insurance is not reasonably available for a flood damaged facility. In denying the appeal, FEMA cited Section 311 of the Stafford Act, which requires applicants who receive assistance under section 406 of the Act to obtain and maintain insurance in the amount of eligible damage to the facilities.<sup>223</sup> Therefore, an insurance commissioner cannot certify that flood insurance is not available at a reasonable cost.<sup>224</sup>

Two separate second appeals in California also pertained to the insurance commissioner's certification. An analyst from California's Department of Insurance, vice the Insurance Commissioner, had certified the reasonableness of insurance available from the NFIP. Both appeals were denied as the Insurance Commissioner did not provide the certification based on the grounds of availability, adequacy, or necessity under section 311. Additionally, FEMA's response also stated, "affordability is not a viable argument if facilities are eligible for coverage under the federally-subsidized NFIP."<sup>225</sup>

The State Insurance Commissioner, responsible for regulation of such insurance, could certify for facilities required to obtain and maintain insurance from eligible disaster assistance from flood. However, the application of the Insurance Commissioner's certification would differ from the facilities location inside or outside of a SFHA. For facilities outside a SFHA, the requirement is for facility owners to obtain and maintain insurance for insurable damaged facilities that have been damaged by flood and have requirement to obtain and maintain insurance in the amount of eligible disaster assistance **when it is reasonably available, adequate, and necessary**. Reasonably available, adequate, and necessary could conceivably apply to the entire O&M requirement, other than the

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<sup>223</sup> Carlos Castillo, "Second Appeal—Texas Parks and Wildlife Department, PA ID 000-U00FB-00, Insurance Waiver, FEMA-1606-DR-TX," Letter of February 21, 2008.

<sup>224</sup> Ibid.

<sup>225</sup> Carlos Castillo, "Second Appeal—City of Los Angeles, PA ID 037-44000-00, Insurance Waiver, FEMA-1577-DR-CA," Letter of February 22, 2008; and Carlos Castillo, "Second Appeal—EPICC Ahmanson Senior Center, PA ID 037-44000-00, Insurance Waiver, FEMA-1585-DR-CA," Letter of February 22, 2008.

NFIP policy limits for the building or its contents, although it is very unlikely that no insurance would be reasonably available. For facilities inside a SFHA, the requirement is for facility owners to obtain and maintain insurance for insurable damaged facilities that have been damaged by flood and have requirement to obtain and maintain insurance in the amount of eligible disaster assistance. Reasonably available, adequate, and necessary would only apply to the obtain and maintain requirement **in excess of a Standard Flood Insurance Policy**. As such, the State Insurance Commission could certify the reasonableness of insurance amounts in excess of a standard flood insurance policy, if such excess flood insurance was not reasonably available, adequate, and necessary.

The State Insurance Commissioner's role and authority is well defined in the history of insurance in the United States both in practice and in law. With respect to disaster assistance, FEMA shall not require greater types and extent of insurance than are certified to him as reasonable by the appropriate State insurance commissioner responsible for regulation for such insurance. This authority does have limitations but the authority is broad in the ability to reduce a facility owner's obtain and maintain insurance requirements depending on the type of peril and location in relation to a SFHA.

The Insurance Commissioner's Certification, once acknowledged by the Regional Administrator, is effective until the next disaster declaration.<sup>226</sup> Should the facility be damaged in a subsequent event, the certification would have to be resubmitted and the obtain and maintain requirement once again waived by the Regional Administrator.

#### **D. BLANKET POLICIES, POOL INSURANCE OR SOME COMBINATION**

Blanket policies, pool arrangements or some combination of these options are permitted for facilities for protection of hazards other than flood in order to effective balance risk management and the cost of insurance.<sup>227</sup> However, they

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<sup>226</sup> Federal Emergency Management Agency, *Disaster Operations Legal Reference*, 5–81.

<sup>227</sup> 44CFR, § 206.253(b)(2).

do not alleviate the obtain and maintain requirement. Assistance under section 406 of the Stafford Act will be approved only on the condition that the grantee obtained and maintained such types and amounts of insurance as are reasonable and necessary to protect against future loss to such property from the types of perils which caused the major disaster.<sup>228</sup>

The insurance reduction from a previous disaster insurance purchase requirement is commonly called the “5903 reduction.”<sup>229</sup> This reduction is required by the Stafford Act and 44 CFR to reduce the eligible damages by the federal investment in the facility from a previous event.

Blanket insurance policies are not permitted under the NFIP.<sup>230</sup>

## **E. DEDUCTIBLES**

The eligibility of deductibles in a subsequent event of a similar type is treated differently dependent on the type of peril (flood or other than flood) and type of policy (blanket or non-blanket). The obtain and maintain requirement in a subsequent event for flood perils is based on insurance proceeds.<sup>231</sup> Therefore, for flood perils, FEMA deducts the total insurance proceeds received or anticipated from the total eligible disaster assistance for the facility. This reduction in assistance would not include the deductible. For other than flood, the type of policy must be evaluated as the insurance reduction for blanket policies, pool arrangements or some combination is based on eligible damage sustained on the previous disaster.<sup>232</sup> For non-blanket policies for other than flood damages, a reduction for actual or anticipated insurance is made based on insurance proceeds, making the deductible eligible in a subsequent event. For other than flood, deductibles for blanket policies, pool arrangements or some

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<sup>228</sup> 44CFR, § 206.253(b)(1).

<sup>229</sup> Federal Emergency Management Agency, DAP 9580.2, “Insurance Responsibilities for Field Personnel” (June 4, 2007).

<sup>230</sup> Federal Emergency Management Agency, Flood Insurance Manual, 2013, DEF 1.

<sup>231</sup> 44CFR, § 206.252(c).

<sup>232</sup> *Ibid.*, § 206.253(b)(2).

combination are based on insurance eligible damage sustained on the previous event and, therefore, not eligible.

#### **F. TIMING OF THE OBTAIN AND MAINTAIN REQUIREMENT**

The commitment to purchase and maintain insurance must be documented and submitted to FEMA before project approval.<sup>233</sup> In practice, the obtain and maintain requirement is effective at project closure. However, significant delays are possible between completion of the project and closure of the project.

It is the grantee's responsibility to insure the obtain and maintain requirement has been met before providing funds of the grant.

#### **G. EXAMPLES OF OBTAIN AND MAINTAIN IN PRACTICE**

Tables 8, 9, and 10 show graphic examples of obtain and maintain requirements in practice. All three examples are for other than flood perils.

Table 8 is an example of specific policy (non-blanket policy), in which case the deductible would be eligible in a subsequent event caused by a similar type hazard. In the example, the facility sustained \$125,000 of eligible damages due to wind with \$50,000 deductible and an insurance limit of liability of \$100,000. In this case, the deductible is eligible in the second event and eligible costs over and above the limit of liability of the insurance would be eligible provided the facility owner satisfied the obtain and maintain requirement as a condition of the disaster assistance grant from the first event.

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<sup>233</sup> Federal Emergency Management Agency, *Public Assistance Guide*, 123.



Event (Specific Policy)	Deductible	Eligible Damages	Insurance - Limit of Liability	Eligible Costs	Obtain and Maintain Requirement
First Event	\$50,000	\$125,000	\$100,000	\$75,000	\$125,000
Second Event	\$50,000	\$130,000	\$125,000	\$55,000	\$130,000

Table 8. Insurance obtain and maintain considerations for a facility with a specific facility insurance policy.

Table 9 is an example that includes a blanket policy in which case the deductible is not eligible in a subsequent event of the same type hazard. Other details are the same as in Table 8.

Event (Blanket Policy)	Deductible	Eligible Damages	Insurance - Limit of Liability	Eligible Costs	Obtain and Maintain Requirement
First Event	\$50,000	\$125,000	\$100,000	\$75,000	\$125,000
Second Event	\$50,000	\$130,000	\$125,000	\$5,000	\$130,000

Table 9. Insurance obtain and maintain considerations with a blanket insurance policy.

Table 10 is an example that builds on the details in Table 8 and adds an Insurance Commissioner Certification that types and amount of insurance was not reasonably available. After receiving the certification, the obtain and maintain requirement would be reduced to \$110,000 for a specific policy, which is the insurance reasonably available in the example. The Insurance Commissioners Certification would reduce the obtain and maintain requirement for a blanket policy or pool arrangement. However, subsequent disaster assistance would be provided from the original obtain and maintain requirement or \$125,000 in this example. Following the second event, the Insurance Commissioner would again have to certify the insurance reasonably available, if that was the case.

Event (Specific Policy and ICC)	Deductible	Eligible Damages	Insurance - Limit of Liability	Eligible Costs	Obtain and Maintain Requirement
First Event	\$50,000	\$125,000	\$100,000	\$75,000	\$125,000
Second Event	\$50,000	\$130,000	\$110,000	\$20,000	\$130,000

Table 10. Insurance obtain and maintain considerations with a specific insurance policy and Insurance Commissioners certification.

In these examples, the obtain and maintain requirement builds on a specific example and adds the additional details of a blanket policy and an Insurance Commissioners certification in subsequent tables to highlight the complexities of obtain and maintain requirements.

## H. CONCLUSION

The factors associated with the obtain and maintain requirement include the State Insurance Commissioner, types of policies, deductibles, and timing the obtain and maintain requirement as a condition of the grant. The effect on Public Assistance grants from a requirement to **obtain** and then **maintain** insurance involves both the previous grant and the future grant with respect to the insurance requirement. The State Insurance Commissioner has broad authorities for other than flood perils and limited authority for eligible damages due to flood. The type of insurance policy has an impact on the disaster assistance provided on a facility with an obtain and maintain requirement. This impact also applies to the eligibility of deductibles in a subsequent event. Finally, the chapter addressed questions regarding **when** the obtain and maintain requirement is indeed a requirement.

Chapter VI will address the resiliency of communities and the Hazard Mitigation Grant Program. Both are important components of reducing the cost of future disasters in addition to community resilience.

## **VI. RESILIENCY AND HAZARD MITIGATION**

The chapter will address the complex subject of promoting resiliency and hazard mitigation in public facilities. Both areas of interest are critical in reducing the costs of future disasters and building communities that are more resilient. Federal encouragement can enhance resiliency and stress the importance of resiliency to local communities. The chapter will also address law and regulation of hazard mitigation, mitigation planning, funding mechanisms, and government incentives for hazard mitigation.

The importance of this concern and reducing the cost of future disasters also has the attention of Congress as delineated in the Sandy Recovery Improvement Act of 2013. In section 1111 of the Act, Congress required the development of a National Strategy to reduce future costs, loss of life, and injuries associated with extreme disaster events in vulnerable areas of the United States. Two of the four components of the strategy include the requirement to consider the vulnerability of the United States to damage from flooding, severe weather events, and other hazards and recommendations on how to improve the resiliency of local communities and states for the purpose of lowering future costs of disaster response and recovery.<sup>234</sup>

### **A. RESILIENCY**

Resiliency is defined by Merriam-Webster as the capability of a strained body to recover its size and shape after deformation caused by especially of compressive stress or the ability to recover from or adjust easily to misfortune or change.

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<sup>234</sup> Sandy Recovery Improvement Act of 2013, Section 1111.

More specifically to the nation, the term "resilience" refers to the ability to adapt to changing conditions and withstand and rapidly recover from disruption due to emergencies.<sup>235</sup> The Department of Homeland Security's efforts to build a "resilient Nation includes fostering a Whole Community approach to emergency management nationally; building the Nation's capacity to stabilize and recover from a catastrophic event is a top mission of the Agency."<sup>236</sup>

FEMA's Mitigation and Insurance Strategic Plan defines resiliency as "the ability of communities to withstand disasters" and "create communities that are able to not only survive disasters, but come through them safely, quickly, and securely."<sup>237</sup>

Presidential Policy Directive Eight addresses resiliency, Congress has addressed resiliency through the Sandy Recovery Improvement Act and the development of a nation strategy, and FEMA Mitigation and Insurance Strategic Plan has addressed resiliency as a top goal. FEMA's "Advance Disaster-Resilient Sustainable Communities" goal includes empowering communities to build "grassroots support of disaster-resilient community planning and recovery."<sup>238</sup>

Resiliency is the ability for a community to recover faster if impacted by an event and develop and construct structures and infrastructure that will withstand the threats to that community. Communities will never be totally safe from disasters. Communities need to eliminate policies, and actions that lure citizens into a false sense of security from disasters, in addition to not viewing disasters as problems that can be solved in isolation but rather as symptoms of broader

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<sup>235</sup> White House, Presidential Policy Directive 8, National Preparedness (March 30, 2011).

<sup>236</sup> Department of Homeland Security, Strategic Plan 2012–2016, February 2012, 15.

<sup>237</sup> Federal Emergency Management Agency, Mitigation and Insurance Strategic Plan 2012–2014 (Washington, D.C.: FEMA P-857, September 2011), 4.

<sup>238</sup> *Ibid.*, 24.

and unaddressed problems.<sup>239</sup> Prior to a disaster or traumatic event, communities have the opportunity to upgrade quality of construction and mitigate risks to the community to better resist subsequent events.<sup>240</sup>

The importance of building a resilient nation is a shared commitment between the federal, state, tribal, and local communities. While building a resilient nation is, and should be, addressed before and after disasters, the Public Assistance program, insurance, and hazard mitigation must be focused on increasing resiliency. As budgets become more stretched across the nation, the pooling of resources in the repair, restoration, reconstruction, and replacement of facilities becomes more of a challenge and requires all levels of government to be collaborative and thoughtful in recovery efforts. Recovery for a disaster stricken community should include measures to reduce future risk, which will require increased local and government investment in mitigation activities, in order to increase the resiliency of their community. Expanding on the opportunities to minimize risks to multiple hazards during recovery and strengthening the ability to withstand and recover from future disasters will lead to a community's increased resiliency and reduce the cost of future disasters.

## **B. HAZARD MITIGATION**

Hazard mitigation plays a crucial role in the resiliency of states and local communities. The intent of Congress is to encourage hazard mitigation measures to reduce losses from disasters including development of land use and construction regulations.<sup>241</sup>

The principles of hazard mitigation are to foster local resiliency and responsibility for disasters in addition to recognizing that sustainable, vital local economies are essential.<sup>242</sup> Time after time, local leaders fail to take advantage

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<sup>239</sup> Mileti, *Disasters by Design*, 287.

<sup>240</sup> *Ibid.*, 230.

<sup>241</sup> The Stafford Act, Section 101.

<sup>242</sup> Mileti, *Disasters by Design*, 30.

of the recovery period to reshape their devastated communities.<sup>243</sup> While the challenge is easier said than accomplished, the post disaster period should be viewed as providing an unique opportunity for change, not only to building local capability for recovery, but for long term sustainable development.<sup>244</sup>

The recovery process should be used as opportunity to advance programs already in place.<sup>245</sup> Prior preparation through hazard mitigation planning and the Threat and Hazard Identification and Risk Assessment (THIRA) process provides and, in some cases, mandates this planning. Hazard mitigation planning will be covered in more detail in section D of this chapter.

The THIRA is an all-hazards capability-based assessment tool for uses by all jurisdictions.<sup>246</sup> The tool is a 5-step process to assist in the communities in understanding its threats and hazards and how their impacts will affect the community. The planning process allows for development of capability targets and the commitment of appropriate resources to close the gap between a target and a current capability or sustaining existing capabilities that are on target.

### **C. AUTHORITIES FOR HAZARD MITIGATION IN THE STAFFORD ACT**

The Stafford Act addresses hazard mitigation in two sections which provide different authorities on providing federal funds for mitigation. The first is under section 406; FEMA has the ability “to fund hazard mitigation measures that the State or local government determines to be necessary to meet a need for governmental services and functions in the area affected by the major disaster.”<sup>247</sup> The authority is based on a project by project basis to enhance and mitigate damages to specific projects. Mitigation under section 406 is eligible to

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<sup>243</sup>Mileti, *Disasters by Design*, 236.

<sup>244</sup> Ibid., 238.

<sup>245</sup> Ibid., 230.

<sup>246</sup> Federal Emergency Management Agency, Use of Threat and Hazard Identification and Risk Assessment for Preparedness Grants, April 2012, 1.

<sup>247</sup> The Stafford Act, Section 406(c)(1)(B)(iii) and Section 406(c)(2)(B)(iii).

both public facilities and eligible private non-profits. Under Section 406, mitigation funds are only available for the damaged elements of a facility to prevent future damage.

Section 406 of the Stafford Act provides the authority for disaster assistance for permanent work, categories C-G under the Public Assistance program. Typically, the federal share of assistance under this section is 75 percent of the eligible cost of repair, restoration, reconstruction, or replacement of facilities.<sup>248</sup> The section also requires the President to promulgate regulations to reduce the federal share of assistance to not less than 25 percent in the case of the repair, restoration, reconstruction, or replacement of any eligible public facility or private nonprofit facility following an event associated with a major disaster (1) that has been damaged, on more than one occasion within the preceding 10-year period, by the same type of event; and (2) the owner of which has failed to implement appropriate mitigation measures to address the hazard that caused the damage to the facility.<sup>249</sup> To date, the regulations to implement this section have not been promulgated.

Hazard mitigation under Section 404 is the more traditional Hazard Mitigation Grant Program. This program gives the President the authority to contribute up to 75 percent of the cost of hazard mitigation measures, which are cost-effective and which substantially reduce the risk of future damage, hardship, loss, or suffering in any area affected by a major disaster.<sup>250</sup> Typically, a presidential disaster declaration will include the Hazard Mitigation program state-wide, while the public or individual Assistance programs are designated for the specific counties or parishes impacted. This allows hazard mitigation funding to be used across the entire state.

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<sup>248</sup> The Stafford Act, Section 406(b)(1).

<sup>249</sup> Ibid., Section 406(b)(2).

<sup>250</sup> Ibid., Section 404.

The contribution under this section 404 for a major disaster is 15 percent for disaster assistance of less than \$2 billion. For larger disasters, the federal contribution for section 404 mitigation is 10 percent for declared disasters with \$2 to \$10 billion of assistance provided or 5 percent, for disaster or over \$10 billion of over \$10 billion in assistance provided.<sup>251</sup>

Section 404 of the Hazard Mitigation Grant Program is program administered by states.<sup>252</sup> A large component of section 404 hazard mitigation is property acquisition and relocation and governance with respect to the properties within a floodplain.<sup>253</sup>

Summary of 404 and 406 Mitigation differences is listed in Table 11.<sup>254</sup>

<b>404 Hazard Mitigation</b>	<b>406 Hazard Mitigation</b>
Separate program run by the State	Implemented through the PA Program
Applies to structural measures and to non-structural measures (such as planning, property acquisition, drainage projects)	Applies only to structural measures and does not apply to buyouts
Applies throughout the State in most disasters	Must apply to the damaged element of the facility
The formula for calculating the HMGP allocation for States with a standard State mitigation plan is based on 15% of the first \$2 billion of estimated aggregate amounts of disaster assistance. For amounts greater than \$2 billion, a sliding scale is used to make allocation determinations. States with enhanced mitigation plans are eligible for a 20% HMGP formula.	No program-wide limits on funds, but each project must be cost effective and approved by FEMA

Table 11. Summary of Hazard Mitigation Differences (from Federal Emergency Management Agency, *Public Assistance Guide*, FEMA 322, June 2007, 124)

<sup>251</sup> The Stafford Act, Section 404.

<sup>252</sup> Ibid., Section 404(c).

<sup>253</sup> Ibid., Section 404(b).

<sup>254</sup> Federal Emergency Management Agency, *Public Assistance Guide*, 124.



The Stafford Act also addresses hazard mitigation planning for state, local, and tribal governments.<sup>255</sup> Identifying the natural hazards, risks, and vulnerabilities of the area under the jurisdiction of the government is the primary objective and intent of Congress in this section. This section also authorizes an additional 5% for federal funding for the development of an enhanced hazard mitigation plan outlines the requirements of the enhanced plan.

#### **D. HAZARD MITIGATION PLANNING**

State, local, or tribal governments develop a mitigation plan that outlines processes for identifying the natural hazards, risks, and vulnerabilities of the area under the jurisdiction of the government.<sup>256</sup> These plans are approved by FEMA as required by the Stafford Act.

The requirement for the plans is different between a grantee and a subgrantee. Grantee is the government to which a grant is awarded, which is accountable for the use of the funds provided.<sup>257</sup> The grantee is the state and tribal governments electing to be a grantee. State plans, and hazard mitigation plans for tribes choosing to be a grantee, are submitted for approval every three years and include:<sup>258</sup>

- Identify the natural hazards, risks, and vulnerabilities of areas in the state;
- Support development of local mitigation plans;
- Provide for technical assistance to local and tribal governments for mitigation planning; and
- Identify and prioritize mitigation actions that the state will support, as resources become available.

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<sup>255</sup> The Stafford Act, Section 322(a).

<sup>256</sup> Ibid., Section 322(a).

<sup>257</sup> 44 CFR, § 201.2.

<sup>258</sup> The Stafford Act, Section 322(a).

For grantees, a mitigation plan is required for permanent work, categories C-G, under a Stafford Act declaration.<sup>259</sup> Without a grantee's approved or approvable plan, all jurisdictions (i.e., all subgrantees) are not eligible for permanent work funding.

Hazard mitigation plans developed by a local government, or hazard mitigation plans for tribes choosing to be a subgrantee, shall include: (1) a description of actions to mitigate hazards, risks, and vulnerabilities identified under the plan; and (2) establish a strategy to implement those actions.<sup>260</sup>

A state may submit an enhanced state mitigation plan which will increase the federal share of assistance provided to the grantee. A grantee with a FEMA approved enhanced plan at the time of a disaster declaration is eligible to receive increased funds under the HMGP, based on 20% of the total estimated eligible Stafford Act disaster assistance.<sup>261</sup> An enhanced hazard mitigation plan will include the following additional factors in determining whether to increase the percentage from 15% to 20%:<sup>262</sup>

- Eligibility criteria for property acquisition and other types of mitigation measures;
- Requirements for cost effectiveness that are related to the eligibility criteria;
- A system of priorities that is related to the eligibility criteria; and
- A process by which an assessment of the effectiveness of a mitigation action may be carried out after the mitigation action is complete.

As of April 2012, all states and territories have submitted FEMA approved hazard mitigation plans. An additional 105 Indian tribal governments have FEMA-approved tribal mitigation plans. A total of 20,202 communities have FEMA approved local multi-hazard mitigation plans. Communities and tribes with

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<sup>259</sup> 44 CFR, § 201.4(a) and § 206.226(b).

<sup>260</sup> The Stafford Act, Section 322(b).

<sup>261</sup> 44 CFR, § 201.5(a).

<sup>262</sup> The Stafford Act, Section 322(e)(2).

planned mitigation strategies include 69% of the nation's population. Nine states have approved enhanced plans, which include California, Florida, Georgia, Iowa, Kentucky, Missouri, Nevada, Washington, and Wisconsin. These nine states are eligible for 20% hazard mitigation funding instead of the standard 15% funding.

#### **E. FUNDING MITIGATION PROJECTS**

The budgets of all communities are stretched to the limit. Local community budgets have been stretched for years. Now, state and federal budgets are of equal concern.

As addressed, all the disaster assistance programs require cost-shared funding for non-federal entities. Permanent work, categories C through G, requires a 25% non-federal match for most declared disasters. For catastrophic events where obligated disaster assistance is above \$133 per capita, for FY13, the federal share is increased to 90%. Regardless, the 10% or 25% non-federal share can be overwhelming to an already devastated community. While some states will fund a portion of the non-federal share, most local communities are responsible for the entire non-federal cost share.

FEMA can fund up to 75% of the eligible costs of each mitigation project. The state or grantee must provide a 25% match, which can be accumulated from a combination of cash, in-kind sources, or materials. Multiple resources, primarily state and local communities, can provide the non-federal share cost. Funding from only one federal source can be used for the 25% share. Funding provided to states under the Community Development Block Grant (CDBG) program through the Department of Housing and Urban Development can be used to meet the non-federal share requirement. Grants awarded to small impoverished communities may receive a federal cost share of up to 90% of the total amount approved to implement eligible approved activities.

The CDBG program works to ensure that decent affordable housing, to provide services to the most vulnerable in our communities, and create jobs through the expansion and retention of businesses. As part of CDBG, the

Disaster Recovery Assistance program is a supplemental appropriation through the Housing and Urban Development Agency to assist the recovery of low-income areas. The grants are nonrecurring, noncompetitive grants that consider disaster recovery needs that are unmet by other federal resources. The funding is made to eligible applicants of the declared disaster with unmet recovery needs and the capability to carry out a disaster recovery program. The Sandy Recovery Improvement Act appropriated \$16 in CDBG funds for Hurricane Sandy and other eligible disasters in calendar year 2011, 2012, and 2013.<sup>263</sup> Previously, according the Housing and Urban Development documentation, Congress appropriated \$400 million in 2012, \$100 million in 2010, and \$9.4 billion in 2008. Appropriations over \$1 billion have only occurred in four years.

- FY 2002 to assist post September 11 recovery efforts.
- FY 2006 to assist victims of Hurricane Katrina, Rita, and Wilma.
- FY 2008 to supplement Louisiana homeowner assistance program, to assist recovery from the Midwest floods, and to assist recovery from all 2008 disasters including Hurricanes Gustav, Ike, and Dolly.
- FY 2013 to assist recovery from Hurricane Sandy and 2011, 2012, and 2013 disasters.

CDBG funding can be an important component of hazard mitigation funding. However, state and local communities will be the primary source in obtaining funding for the non-federal cost share. Additionally, local jurisdictions, tribes, and states are in the best position to maximize the effectiveness of dollars spent in recovery. As budgets become more strained, additional partners will be needed in an overall approach to building resiliency in communities, including the private sector, additional state and local resources, and insurance companies.

## **F. INSURANCE COMPANY'S INCENTIVE FOR MITIGATION**

Insurance itself is not considered a mitigation measure.<sup>264</sup> Insurance redistributes funding, insurance proceeds and premiums, based on carefully

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<sup>263</sup> Sandy Recovery Improvement Act of 2013, 2013, Division A, Title X, Chapter 9.

<sup>264</sup> Mileti, *Disasters by Design*, 172.

designed risk based analysis. Insurance companies, however, can encourage the adaption of loss reduction measures by providing the proper financial incentives. There are four principal incentives that insurance companies can provide to facilitate mitigation measures:<sup>265</sup>

- Engage in **education and information** to enlighten property owners in the risk that they face and the mitigation measures that can be taken to lessen the chances of loss.
- Insurance companies participate in the **model building code process** in order to promote building codes that provide provisions to reduce damage to property.
- Provide **financial incentives** for property owners who implement the mitigation measures.
- Insurance companies could **limit the availability of insurance** until mitigation measures implemented, retrofitted, or built to an acceptable standard.

Private insurance can pursue these sustainability principles, but the problems may be too large for a single industry to handle. Public programs such as disaster relief also have a role to play, but public programs also need to provide the right incentives to encourage and enforce cost effective loss reduction measures.<sup>266</sup>

## G. CONCLUSION

Local based recovery approaches are most effective to the long term sustainability of the communities in which they live.<sup>267</sup> Federal and state resources must assist communities incorporate resiliency and sustainability goals into their post disaster recovery planning both in technical assistance and in financial incentives. The Stafford Act provides a federal share of funding for both 404 and 406 mitigation measures. The Act also provides the disincentive for facilities where mitigation measures were not taken and the facility sustains a repetitive loss.

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<sup>265</sup> Mileti, *Disasters by Design*, 172.

<sup>266</sup> Ibid., 174.

<sup>267</sup> Ibid., 240.

Disasters happen—the risks cannot be completely eliminated.<sup>268</sup> The risks can be reduced through a more complete understanding of the value and importance of mitigation and resiliency. Along with the financial incentives and disincentives to hazard mitigation, communities can be more resilient and better prepared to withstand an event and recover faster, stronger, and more cost effective.

Chapter VII will look at the best practices of the Commonwealth of Australia and Dominion of Canada in how these countries approach disaster assistance, disaster declarations, and supplement aid to their communities.

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<sup>268</sup> Federal Emergency, Management Agency, Mitigation and Insurance Strategic Plan, 31.

## **VII. COMPARATIVE ANALYSIS**

In finding the best approach to insurance law, regulation, and policy in FEMA's Public Assistance program, one would have to ask, "is someone else doing it better?" And, "can we learn from their best practices?" Australia and Canada have Emergency Management Agencies that implement insurance slightly different than the United States and offer policies and procedures that can assist in the implementation of the program in the United States. While the policy of insurance is the focal point of this comparison, however, two issues are important before examining the insurance policies of Australia and Canada.

- Are the number of declarations in Australia and Canada comparable to the U.S?
- What criteria do Australia and Canada utilize in the determination of a disaster declaration and how does this compare to the U.S. process?

After understanding the declaration process in Australia and Canada, we may better understand the role of insurance in disaster assistance programs and in assisting the recovery of communities. In examination of insurance, how do Australia and Canada treat insurance in their equivalent of the public assistance programs in providing assistance to the states, territories, and provinces? This brings several questions to the forefront in comparing and improving U.S. policy.

- How do Australia and Canada view insurance deductibles?
- Do Australia and Canada require applicants to maintain insurance?
- Are their best practices that are being conducted in Australia and Canada that can benefit the U.S.?

This chapter will provide analysis of the insurance requirements for Australia and Canada through their equivalent of the Public Assistance program. In order to better understand the role of insurance in disaster assistance, this chapter will briefly review the style of government of each country, the declaration criteria for a disaster declaration and address the public assistance programs including insurance requirements and mitigation requirements. The analysis will

then compare the programs of the three countries and evaluate the components of the programs in Australia and Canada, which could be employed in the United States. In the end, best practices from all three countries will be important in re-defining law, regulation, and policy in FEMA's Public Assistance program as related to insurance.

## **A. THE COMMONWEALTH OF AUSTRALIA**

The Commonwealth of Australia is the sixth largest country in the world.<sup>269</sup> In population, Australia ranks fifty-third with slightly over 22 million people. The majority (89%) of the population lives in cities and towns, which makes the Australia highly urbanized.<sup>270</sup> The country's Gross Domestic Product (GDP) is \$960 billion or 19<sup>th</sup> in the world. GDP is a typical benchmark in defining the nation's economy. On a per capita basis, Australia's per capita income is \$42,400, which ranks Australia as 20<sup>th</sup> in the world. Generally, Australia is a highly urbanized, wealthy country spread over a large geographic area.

The Commonwealth of Australia was formed on January 1, 1901 with the promulgation of the Constitution in July 1900.<sup>271</sup> The form of government is a constitutional monarchy with a federalist system of governance.<sup>272</sup> Australia has three levels of government, which include the federal Australian Government, the governments of the six states and two territories, and 700 local government authorities.

The constitutional monarchy is the Queen of England and represented in Australia by the Governor-General.<sup>273</sup> Currently, Queen Elizabeth II is the head of state. The Queen appoints the Governor-General of Australia, as her

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<sup>269</sup> Nadav Morag, "Comparative Homeland Security: Global Lessons" (Hoboken, NJ: John Wiley and Sons, 2011), 34.

<sup>270</sup> Ibid., 35.

<sup>271</sup> The Constitution Act Constituting the Commonwealth, July 9, 1900.

<sup>272</sup> Morag, "Comparative Homeland Security," 36.

<sup>273</sup> Ibid.



representative, on the advice of the elected Australian Government. The Governor-General appoints ministers on the advice of the Prime Minister.

The Commonwealth government is broken into three arms. The legislature, Executive, and Judiciary form the federal government. The Prime Minister who serves as Australia's Head of Government, leads the Executive arm. A Minister is a member of the legislature who has been chosen to also work as part of the executive branch of government, typically with responsibility for matters on a specific topic. Ministers, including the Prime Minister, are not mentioned anywhere in the Constitution, but their roles are accepted as being important conventions that help to ensure an efficient executive arm of government.

The legislature arm is known as the Parliament of the Commonwealth or Parliament. The Senate (Upper house) is twelve senators from each state and two senators per territory to form the body of 76 members.<sup>274</sup> The House of Representatives (Lower House) is members from each of the 150 constituencies.<sup>275</sup> Both houses must pass laws while the House of Representatives is responsible for appropriations.<sup>276</sup>

There are two major political groups that usually form government. The first is the Australian Labor Party. The second is the Coalition, which is a formal relationship of the Liberal Party and its minor partner, the National Party.

Australia Emergency Management Agency (EMA) coordinates the central governments large-scale emergencies.<sup>277</sup> Like the United States, the state and territory governments have responsibility for emergency management within their jurisdictions.<sup>278</sup> The premise of the emergency management agency in the

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<sup>274</sup> Morag, "Comparative Homeland Security," 36.

<sup>275</sup> Ibid.

<sup>276</sup> Ibid.

<sup>277</sup> Ibid., 311.

<sup>278</sup> The Attorney-General's Department, Australian Emergency Management Arrangements (2009), 5.

Australia is based on partnerships between levels of government, business and industry, and the community. These partnerships strive to minimize vulnerabilities to hazards, protect life, property, and the environment. Additionally, the partnerships minimize adverse social affects during emergencies and facilitate recovery, rehabilitation, and reconstruction.<sup>279</sup> This approach is comprehensive and integrated in order to contribute to the development and maintenance of disaster and emergency ready Australian community. All programs and arrangements in emergency management work toward this goal.<sup>280</sup>

The tiered approach to emergency management is common to Australia and many other countries. Each level of government has the responsibility within its own organization for emergency planning, preparedness, and mitigation in relation to land, property and the environment, assets and infrastructure, agencies and programs.<sup>281</sup> As such, the national framework for emergency management demands a high level of collaboration and coordination with all stakeholders. These roles and responsibilities extend beyond the tiers of government to individual families and individuals. The national framework addresses the principal responsibility of households for safeguarding their property and assets against risks from hazards through risk identification, mitigation measures, and adequate insurance where available and reasonably affordable.<sup>282</sup> The national plan also charges communities to become disaster ready promoting awareness and preparedness, mitigation measures to reduce risk, and promotion a culture of support and recognition for volunteers.

The insurance industry is a key a partner in the national plan. The industry is a strong advocate of risk mapping and mitigation and the industry stands to gain much in reduced commercial loss exposure from increased

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<sup>279</sup> Ibid., 5.

<sup>280</sup> Ibid.

<sup>281</sup> Ibid., 8.

<sup>282</sup> Ibid.

mitigation.<sup>283</sup> The insurance industry is a major beneficiary of emergency response efforts in the fact that emergency workers minimize bush fire and storm damage. Therefore, the insurance industry can play a vital role in two areas. One, the industry can assist emergency management agencies with the necessary research and investment for improved hazard identification, risk assessment and mitigation efforts. Two, the industry can provide insurance against emergencies, including flood and cyclone, at affordable premiums commensurate with risk levels, especially where mitigation measures have taken place.<sup>284</sup>

In the area of infrastructure, the national plan continues to promote mitigation, planning, and resilience including establishing priorities in the restoration of service.<sup>285</sup>

The national plan looks at recovery as the reconstruction, rehabilitation, and reestablishment across all elements of physical, social, emotional, psychological, environmental, and economic aspects of the community. However, recovery is more than replacement of what was destroyed. The aim of recovery is to leave the community more resilient than before the event.<sup>286</sup> Recovery in Australia is based on six core principles—understanding the context, recognizing the complexity, using community-led approaches, ensuring coordination of all activities, employing effective communication, acknowledging and building capacity.<sup>287</sup>

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<sup>283</sup> The Attorney-General's Department, Australian Emergency Management Arrangements, 11.

<sup>284</sup> *Ibid.*, 11.

<sup>285</sup> *Ibid.*, 12.

<sup>286</sup> *Ibid.*, 15.

<sup>287</sup> *Ibid.*, 16.

The recovery programs are rooted in the encouraging mitigation and preparedness measures. The process of the declaration is much different in Australia from the United States. The recovery programs for reimbursement are based on the following categories:<sup>288</sup>

**Category A** measure is assistance to Individuals to alleviate personal hardship or distress as a direct result of a natural disaster. The Assistance can range from emergency food to clothing, replacement of essential items of furniture, essential repairs to housing, demolition or rebuilding to restore housing, debris removal, and counseling are a few of the assistance that may be provided.

**Category B** measure is assistance to restoration or replacement of essential public assets damaged as a result of the natural disaster, loans, subsidies, or grants to certain businesses, and counter disaster operations for the protection of the general public.

**Category C** measure is a community recovery package designed to support a holistic approach to the recovery of regions, communities, or sectors severely affected by a natural disaster.

**Category D** measure is an act of relief or recovery carried out to alleviate distress or damage in circumstances that are in the opinion of the minister, exceptional.

Disaster declarations are made by the state after informing the Attorney-General and Minister for Emergency Management as soon practicable. When the state announces assistance measures under the Natural Disaster Relief and Recovery Arrangements (NDRRA), the state must announce publically at a joint press conference with the Minister or a representative, notify the House of Representative for the declared jurisdiction, and the state must reach a prior agreement with the Commonwealth on announcements or assistance under NDRRA.

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<sup>288</sup> Attorney-General and Minister for Emergency Management, Natural Disaster Relief and Recovery Arrangements (2012).

The reimbursement process is related to assistance provided and thresholds based on state revenue. The recovery programs are based on two thresholds and cost shares based on the level of damage. The first threshold is based on .225% of the state revenue. The second threshold is 1.75 times the first threshold. The cost share provisions are based on these thresholds for the categories of assistance that were previously addressed. Additionally, the time limits of expenditure are limited to 24 months following the end of the financial year in which the disaster occurred.<sup>289</sup>

Using Queensland as an example, the state revenue for Queensland is \$41,957,000,000. The first threshold is the state revenue times .225%, or \$94,403,250. The second threshold is the first threshold times 1.75, or \$165,205,688. For total eligible expenditure for all events in the 2012/2013 year the funding formula is listed in Table 12.

\$0	to	\$94,403,250	100%	Queensland Funded		
\$94,403,250	to	\$165,205,688	50%	Queensland Funded	50%	Commonwealth Funded
	>	\$165,205,688	25%	Queensland Funded	75%	Commonwealth Funded

Table 12. For total eligible expenditure for all events in 2012/2013 (from [http://disaster.qld.gov.au/Financial%20Support/Disaster\\_finance\\_arrangements.html](http://disaster.qld.gov.au/Financial%20Support/Disaster_finance_arrangements.html))

The formula of calculation for Commonwealth assistance further defined as the following:

- If the state's first threshold has not been exceeded, 50 percent of the state expenditure on category A and C measures (Individual Assistance and Community Recovery).
- If the state's first threshold has been exceeded, 50 percent of the state expenditure of category A, B, and C measures. If the second

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<sup>289</sup> Ibid., 9, 10.

threshold is exceeded, the commonwealth's assistance is 75% over the second threshold.<sup>290</sup>

\* If the category A and C measures are higher using the method (a), the state may use (a) for those components.

The first and second thresholds provide criteria for the Commonwealth assistance provided. However, this system is not intended to be a disincentive to insurance needs of states, individuals, and businesses.<sup>291</sup> The insurance requirements set guidelines to minimize the taxpayer role in insurance and provide the requirement for sound risk management. These fifteen guidelines of insurance requirements set the premise of the role of insurance in natural disaster relief and recovery costs. Insurance is not intended to be a distinctive component to the planning, mitigating or allocating of resources. Nor should any of the guidelines discourage governments, individuals, or businesses purchasing insurance to protect assets.

The guidelines require states wishing to be covered by NDRRA to have an independent assessment of their insurance arrangements undertaken by an independent and appropriate specialist, such as the State Auditor-General. The assessment is required to be published and submitted to the Commonwealth. The assessment must be completed every three years, following a significant change in the state's insurance arrangements, or following a major insurable disaster occurring in the state.<sup>292</sup>

The guidelines require states to have reasonably adequate capital or access to capital to fund liabilities or infrastructure losses before being granted funds under the NDRRA. The following funding mechanisms are not limiting but provided as a guideline: (1) commercial insurance/reinsurance; (2) any state or Council of Australian Government fund or pool; or (3) state department premium contributions.

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<sup>290</sup> Attorney-General and Minister for Emergency Management, 2012, 10.

<sup>291</sup> Ibid., 5.

<sup>292</sup> Ibid.

The guidelines require the Commonwealth Attorney-General to consult with the Department of Finance and Deregulation (DoFD) to ensure a complete and comprehensive evaluation of the assessment as provided by the state. In addition, the consultation involves the relevant state. This review will be completed within 90 days. The Attorney-General will consider the full report and make recommendations to the state in the areas of appropriateness of the state's insurance arrangements and differential thresholds or differential rates that should apply. While the DoFD's recommendation does not have to be accepted by the Attorney-General, recommendations not accepted must be presented to parliament with an explanation of the rejection.

This assessment compiled by the state, reviewed by the DoFD, and approved by the Attorney-General. The review will include the following principles:<sup>293</sup>

- States have a responsibility to put in place insurance arrangements which are cost effective for both the state and the Commonwealth;
- The financial exposure borne by taxpayers (at both levels of Government) under the NDRRA Determination should be minimized;
- The onus is on the state to explore a range of insurance options in the market place and assess available options on a cost-benefit basis.

The guidelines require the following items to be reviewed in the evaluation of insurance:<sup>294</sup>

- The nature of any insurance/reinsurance sought and offered;
- The amounts of any premiums and excesses;
- The events and extent of assets covered;
- The amount covered per event;
- Maximum possible loss;

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<sup>293</sup> Ibid.

<sup>294</sup> Ibid.

- Reinstatement terms;
- Claims experience; and
- Any related matters.

Based on the rigorous review by the Attorney-General and the Department of Finance and Deregulation, the state must implement the recommended changes within six months. Failure to implement the Attorney-General 's recommended changes by the state or territory will result in reduced participation in the NDRRA. This reduction will be in accordance with a letter from the Attorney-General within 14 days of the decision to limit NDRRA participation.<sup>295</sup> The implementation of the penalty and the scope of the penalty are still under consideration by the Commonwealth. To date, there has not been a need to implement the reduced participation in the NDRRA.<sup>296</sup>

The insurance guidelines and the Natural Disaster Relief and Recovery Arrangements offer a very efficient method of ensuring states are insured at the appropriate levels of protection. The partnership of insurance companies, states, and the Commonwealth appear to provide a robust and rigorous evaluation of the risk management practices of states before a disaster. This evaluation takes into account all aspects of insurance including the protection of the Australian taxpayer.

## **B. THE DOMINION OF CANADA**

Canada is the world's second largest country.<sup>297</sup> In population, Canada ranks thirty-fifth with slightly over 34 million people. The majority (90%) of the population lives in the southern part of the country due to the harsh and intemperate climate.<sup>298</sup> The country's Gross Domestic Product (GDP), which is defined as the value of all final goods and services produced by the country, is

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<sup>295</sup> Ibid.

<sup>296</sup> Director–Relief and Recovery Programs, National Disaster Recovery Programs Branch, Emergency Management Australia Email (April 19, 2013).

<sup>297</sup> Morag, "Comparative Homeland Security," 28.

<sup>298</sup> Ibid., 29.



nearly \$1.5 trillion or 14<sup>th</sup> in the world. On a per capita basis, Canada's per capita income is \$41,500, which ranks Canada as 24<sup>th</sup> in the world. Canada is an important partner to the United States with a strong government relationship and important trading partner as 80% of Canada's exports are sold to the United States.<sup>299</sup>

The formation of the six providences that shape Canada began in 1867 with the Constitution Act. The piecemealed approach to independence was advanced with the Statue of Westminster in 1931, which granted Canada legislative powers. The Canadian Charter of Rights and Freedoms, passed in 1982, was the final step in complete independence, which gave Canada legislative powers to amend its constitution.<sup>300</sup>

Canada is a constitutional monarchy with the Queen of England serving as the head of state and represented in Canada by the Governor-General.<sup>301</sup> The Queen appoints the Governor-General of Canada as her representative on the advice of the Prime Minister.

Like Great Britain, Canada has parliamentary regime with a Lower House (House of Commons) and an appointed Upper House (Senate).<sup>302</sup> The Governor-General has the authority to appoint the Upper House. However, in practice this role is delegated to the Prime Minister. The Upper House has 105 senators with the role providing advice on bills to the Lower House. <sup>303</sup> The Lower House or House of Commons consists of 308 members who represent the various constituencies across the country.<sup>304</sup>

As Canada's lead department for emergency management as well as other critical functions, Public Safety Canada reports to the Minister of Public

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<sup>299</sup> Ibid.

<sup>300</sup> Ibid., 30.

<sup>301</sup> Ibid.

<sup>302</sup> Ibid., 32.

<sup>303</sup> Ibid., 31.

<sup>304</sup> Ibid., 30.

Safety who is elected to the House Commons. The other agencies under the Minister of Public Safety are the Canada Border Services Agency, Royal Canadian Mounted Police, Canadian Security Intelligence Service, Correctional Service, and Parole Board of Canada. The result is better integration among federal organizations dealing with national security, emergency management, law enforcement, corrections, crime prevention, and borders. Emergency Management is housed within the department of Public Safety Canada.

In the event of a large-scale disaster, the Government of Canada provides financial assistance to provincial and territorial governments through the Disaster Financial Assistance Arrangements (DFAA), administered by Public Safety Canada (PS). The program addresses roles, responsibilities, and cost share provisions.

A province must make requests for assistance under the Disaster Financial Assistance Arrangements (DFAA) within six months of the end of the event.<sup>305</sup> The request is a letter from the Premier of the Province to the Prime minister or from the provincial Minister responsible for Emergency Preparedness to the federal Minister.<sup>306</sup>

The incident period and areas must be defined and accepted for proposes of the DFAA. Final claims must be submitted within five years from the date of approval.

Similar to the U.S., the cost share for Canada is based on per capita population. The cost share is based on \$1, \$3 and \$5 per capita population for the provincial or territory government. As an example, the 2012 population of British Columbia is 4,622,573. Table 13 lists the data for a \$30 million disaster.

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<sup>305</sup> Public Safety Canada, "Guidelines for the Disaster Financial Assistance Arrangements," 2007, 8.

<sup>306</sup> Ibid.

Example Expenditure	British Columbia	Government of Canada
First \$1 per capita (0%)	\$4,622,573	\$0
Next \$2 per capita (50%)	\$4,622,573	\$4,622,573
Next \$2 per capita (75%)	\$2,311,287	\$6,933,860
Remainder (90%)	\$688,714	\$6,198,422
Total Disaster Assistance	\$12,245,146	\$17,754,854

Table 13. \$30 Million disaster in Canada based on current cost share.

The declaration criteria is based on the eligibility of damages and appendix B to the Disaster Financial Assistance Arrangements (DFAA) provides examples of provincial/territorial expenses that may be eligible for cost sharing. Repairs to public buildings and related equipment are an example of eligible expenses, which includes removal of damaged structures constituting a threat to public safety. However, repairs that are eligible for reimbursement through insurance or other government programs are not eligible for DFAA reimbursement.<sup>307</sup>

The DFAA Guideline further defines the role of insurance in the disaster assistance program. Under DFAA, insurance coverage for a specific hazard is determined jointly between Public Safety Canada Regional Director and the province.<sup>308</sup> Any necessary professional advice can be obtained through the insurance Bureau of Canada or a regional insurance broker.

The policy also pertains to small businesses and farm buildings. If insurance is only available for up to a designated fraction of the appraised value of the building, some portion of the uninsured loss may be eligible for disaster assistance.<sup>309</sup> Conversely, for businesses and farms that do not carry insurance, only the losses for which they could not have obtained insurance at a reasonable

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<sup>307</sup> Public Safety Canada, Disaster Financial Assistance Arrangements, Revised Guidelines, March 22, 2012, Appendix B.

<sup>308</sup> Public Safety Canada, "Guidelines for the Disaster Financial Assistance Arrangements," 2007, 14.

<sup>309</sup> Ibid., 27.

cost will be eligible. <sup>310</sup> This ensures equal treatment with those who had insurance coverage. Standard insurance policy deductible amounts are not eligible for assistance.<sup>311</sup>

### C. COMPARISON

In the comparison of insurance as related to the public assistance policy, two factors come into the forefront prior to comparing insurance as related to disaster assistance programs and in the resiliency of public infrastructure. The first is number of disaster declarations. For frame of reference, the Table 14 illustrates the number of declared disasters by country. Since 1979, disaster declarations are made in the U.S. nearly 3 times more than Canada and nearly 7 times more than Australia.

	Australia	Canada	U.S.*
2012	3	5	63
2011	15	18	128
2010	5	25	90
2009	11	21	66
2008	7	43	92
Since 1979	268	645	1819

\*Emergencies (293) and Major Disasters (1526)

Table 14. Number of declared disasters by country (from <http://www.disasterassist.gov.au/DisasterRecoveryExpenditure/Pages/default.aspx>, Canadian Disaster Database, and [www.fema.gov](http://www.fema.gov))

In a dollar comparison, the top disaster in Canada cost approximately \$665,387,416 (\$652,079,667 U.S.) for a winter storm in 1998.<sup>312</sup> The Queensland Flood of 2011 is the most expensive disaster in Australian history

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<sup>310</sup> Ibid.

<sup>311</sup> Ibid.

<sup>312</sup> Public Safety Canada, "Canadian Disaster Database,." <http://www.publicsafety.gc.ca/cnt/rsrccs/cndn-dsstr-dtbs/index-eng.aspx>.

with \$3.9 billion provided in assistance from the NDRRA (\$3.978 billion U.S.).<sup>313</sup> Hurricane Katrina remains the costliest disaster in U.S. history. According to the FEMA website, the public assistance provided to the State of Louisiana is \$11,038,828,689.06.

In comparing the disaster declaration criteria, Canada and U.S. use population while Australia uses revenue as the basis for declaration threshold calculations. The 2011 population of Queensland is 4,548,667, which is comparable to British Columbia and the State of Louisiana.<sup>314</sup> As previously noted, the state revenue for Queensland is \$41,957,000,000. The 2012 population of British Columbia is 4,622,573. The 2012 population of the State of Louisiana is 4,601,893, according to the State's website. Table 15 compares the declaration criteria and federal and non-federal share of funding for disasters of \$30 million, \$100 million, and \$200 million for the three entities. Of note, the minimum declaration is not applicable for Queensland. The Commonwealth contributions do not begin until eligible damages exceed .225% of state revenue for public assistance, or \$94,403,250. The U.S. will increase the federal cost share to 90% at \$133 per capita of disaster relief.<sup>315</sup> For Louisiana, the 90% federal threshold would be applicable when overall damages exceed \$612 million.

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313 The Labor Party of Australia, "Flood Recovery," <http://auslabpartay.weebly.com/flood-recovery.html>.

314 Queensland Treasury, "Population Growth Highlights and Trends Queensland 2011: Population Trends for Statistical Local Areas, Local Government Areas, and Regions," 2011, 1.

315 Federal Register, Notice of Adjustment of Statewide Per Capita Indicator for Recommending a Cost Share Adjustment, Volume 78, No. 29, February 12, 2013.

Declarations Minimum		\$30 Million Disaster		\$100 Million Disaster		\$200 Million Disaster	
		Federal Share	Non-Federal Share	Federal Share	Non-Federal Share	Federal Share	Non-Federal Share
Queensland, Australia	\$94,403,250	\$0	\$30,000,000	\$2,798,375	\$97,201,625	\$61,496,953	\$138,503,047
British Columbia, Canada	\$4,622,573	\$17,754,854	\$12,245,146	\$80,754,854	\$19,245,146	\$170,754,854	\$29,245,146
Louisiana, United States	\$6,304,593	\$22,500,000	\$7,500,000	\$75,000,000	\$25,000,000	\$150,000,000	\$50,000,000

Table 15. Comparison of declaration criteria and disasters for \$30 million, \$100 million, and \$200 million.

The results from the example illustrate the federal and non-federal cost share from three different magnitudes of disasters. Of the three nations, the declaration criterion for Canada offers several advantages. One, for small disasters (i.e., \$30 million), the federal cost share is roughly 59% after applying the cost share formula. This is considerably less federal assistance than the U.S, which contributes a federal share of 75%. For more catastrophic events, the formula leads to more assistance provided to the province. In both the \$100 and \$200 million examples, Canada offers more assistance to the territory or province than the U.S. The Canadian assistance accounts for 81% and 85% for the \$100 million and \$200 million disasters, respectively. For these larger events, the federal share in the U.S. would still be 75%. Although not included in the table, Canadian federal assistance is roughly 88% for a \$500 million disaster. The U.S. assistance would be 90% when assistance crossed the \$612 million benchmark for the State of Louisiana.<sup>316</sup>

The Australian methodology offers a formula based on the state or territory ability to pay for the damages from a major incident. The federal assistance is secondary and supplemental to the local jurisdictions ability to repair and restore damages with the revenue based formula. For small disasters, the Commonwealth does not provide any assistance to the state or territory for public assistance. The Commonwealth assistance is 0%, 3%, 31%,

<sup>316</sup> 44 CFR 206.47: whenever a disaster is so extraordinary that actual Federal obligations under the Stafford Act, excluding FEMA administrative cost. This is typically at \$133 per capita (FY13) of statewide population.

and 57% for a \$30, \$100, \$200, and \$500 million disaster, respectively. For more catastrophic events, the Commonwealth provides more assistance but the percentage of assistance does not exceed 75% without action by the Minister to increase the Commonwealth assistance under Category D.

Each of the declaration criterion offer advantages and disadvantages. Criterion that promotes good risk management, preparedness, supplemental support in large events is the ultimate goal. The Canadian declaration process seems to support the metrics of less assistance for smaller events and more support in the larger, catastrophic events.

In the role and treatment of insurance, Australia, Canada, and U.S. have very different programs. Based on the declaration criterion, Commonwealth assistance is supplemental to state and territory programs. For a \$500 million disaster, Commonwealth assistance is 57% of the total assistance provided. As a result, the insurance programs in Australia are consistently the primary and many times the only relief to state and local governments. Moreover, the concept of managing risk and programs in place to properly ensure the facility owner protects the public infrastructure is the core of the assistance program. The Commonwealth of Australia goes even one-step further with an approval process of the insurance assessment to validate and approve the protection in place. All these steps ensure that the states and territories implement effective risk management programs.

Canada also has a robust insurance program as well. The deductibles are not eligible and the facility owner is expected to maintain a reasonable amount of insurance. If in question, the appropriate insurance experts advise on the insurance reasonably available. In the end, DFAA payments are supplemental to insurance.

The Australian or Canadian models offer advantages and best practices that could alter U.S. policy. Neither model is a perfect fit; however, both offer adaptable components.

The Australian insurance model of the approval of the insurance assessment by the Commonwealth would not be implementable in the U.S. The Stafford Act and 44 CFR codify the role of the State Insurance Commissioner. United States law prescribes that the President shall not require greater types and extent of insurance than are certified by the appropriate State Insurance Commissioner.<sup>317</sup>

However, the fact that commonwealth assistance is supplemental to insurance is very transportable to the U.S. The NDRRA clearly states that the arrangements are not a disincentive to plan, mitigate, and allocate resources for protection of assets. Additionally, the states have a responsibility to ensure insurance arrangements are in place, which are cost effective to the state and Commonwealth.

While U.S. law would not permit the approval of the insurance arrangements every three years, the practice of a pre-disaster dialog offers many advantages. Understanding the current insurance structure within the state would be beneficial to both the state and FEMA in preparedness prior to a major disaster.

The role of insurance in Canada offers several key policies advantages as well. While the state insurance assessments are not approved on a reoccurring basis, insurance is an expectation of the DFAA assistance program. For uninsured facilities, insurance experts advise Public Safety Canada and the state in jointly determining insurance that was available at a reasonable cost. The available insurance reduces the eligible damages to a facility. Examples of the insurance experts are the Insurance Bureau of Canada or a regional insurance broker. This ensures fairness to facility owners who properly insure their buildings with those that are uninsured.

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<sup>317</sup> The Stafford Act, Section 311 (A)(2).



The key principle in Canadian Disaster Financial Assistance Arrangements is Canada assistance is supplemental to insurance and other financial support. Even if a facility was not insured, a deduction in assistance would be made based on reasonable insurance that could have been obtained.

A key component of Canada's insurance program that would be implementable in the U.S. is the review by insurance experts for uninsured facilities. This panel could be structured as to incorporate the State Insurance Commissioner and Insurance experts to stay within existing U.S. authorities. The fact that facility owners are treated fairly and similarly regardless if they do or do not have insurance is a large benefit to the implementation of Canada's Public Assistance program.

Australia's practice of government approval of insurance coverage would be difficult to implement in the U.S. as the State Insurance Commissioner is the authority on the regulation of insurance in each state. While the practice is good and provides for better preparedness in the country, the requirement of federal approval would not work within the U.S. insurance structure.

Several key components to Australia's and Canada's Insurance policy can benefit the U.S. Specifically, these key components are that deductibles are not eligible for federal assistance. Insurance is a requirement as federal assistance is supplemental to insurance coverage, and insurance is not intended to be a distinctive component to the planning, mitigating, or allocating of resources.

#### **D. CONCLUSION**

The declaration criterion for both Australia and Canada provide less or no federal assistance in smaller disasters and increasing the percentage for larger events in a sliding scale. This increases the state, province, or territory participation in the smaller events. As a result, the policy emphasizes the importance of good risk management for public facilities and the accompanying insurance program. This creates an environment of resiliency of infrastructure for the jurisdiction's facilities with or without a Presidential declaration.

The insurance policies as related to FEMA's public assistance program can also gain from the programs being implemented in Australia and Canada. One, the eligibility of deductibles should be reconsidered. Australia and Canada do not reimburse for deductibles. Only the U.S. reimburses facility owners for deductibles. Two, FEMA will reimburse for damages for uninsured facilities in the first disaster. Australia and Canada make adjustments for uninsured facilities based on what was reasonably available (Canada) or based on the approval an insurance assessment (Australia).

Both Australia and Canada appear to maintain a partnership with the insurance industry. The insurance industry is a beneficiary of the mitigation measures and emergency response efforts of emergency management. Australia cites two primary reasons for this partnership. One, the insurance industry can assist emergency management agencies with the necessary research and investment for improved hazard identification, risk assessment and mitigation efforts. Two, insurance companies provide access to affordable insurance against disasters at affordable rates. This is especially true where mitigation measures have taken place.<sup>318</sup> This partnership could be an expansion area for FEMA in promoting more resilient communities with the U.S. insurers.

The U.S. can learn from the many facets of the insurance programs in Australia and Canada to make improvements and alter policy to ensure the U.S. policy places incentives on resiliency and risk management. These changes will ensure the protection of the taxpayer, the local jurisdictions, the state, and the federal government.

Chapter VII will summarize the insurance requirements in FEMA's Public Assistance program that have been addressed in the previous chapters. The focal point is in the area of deductibles, types of insurance policies, mitigation

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<sup>318</sup> The Attorney-General's Department, Australian Emergency Management Arrangements, 2009, 11.

and the requirement of insurance. The chapter will then make recommendations for a path forward for the role of insurance as related to FEMA's Public Assistance program.

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## VIII. RECOMMENDATIONS

After an in-depth review of the law, regulation, and policy related to insurance as related to FEMA's Public Assistance program and the nuances in the applying this guidance, what improvements can be made to better achieve the intent of Congress, promote sound insurance practices in risk management, and avoid the moral hazard of insurance and federal policy? The current regulation was drafted in 1991 and the interim rule has fallen behind with the complexities of today's insurance industry. Additionally, the rescission of a key component of FEMA policy has left a void in the application of deductibles in a subsequent event.

The intent of Congress is that the federal government continues to provide assistance to state and local government in carrying out their responsibilities to alleviate suffering and damage, which result from disasters.<sup>319</sup> Moreover, the intent of Congress is that state and local governments protect themselves by obtaining and maintaining coverage to supplement or replace government assistance.<sup>320</sup> Additionally, Congress provides the intent of encouraging hazard mitigation measures to reduce losses from disasters including development of land use and construction regulations.<sup>321</sup> The Sandy Recovery Improvement Act of 2013 further reiterates the intent of Congress and their focus on resiliency and cost effective measures in disaster assistance. The Act requires the Administrator of the Federal Emergency Management Agency to submit to Congress recommendations for the development of a national strategy for reducing future costs, loss of life, and injuries associated with extreme disaster events in vulnerable areas of the United States.<sup>322</sup> The national strategy is due 180 days from the enactment of the law.

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<sup>319</sup> The Stafford Act, Section 101 (b).

<sup>320</sup> Ibid., Section 101 (b)(4).

<sup>321</sup> Ibid., Section 101 (b)(5).

<sup>322</sup> The Sandy Recovery Improvement Act of 2013, Section 1111(a).

Through the research provided in the previous chapters, this chapter will focus on a brief review of what has been addressed in the research and address the four key principles related to insurance in supporting the intent of Congress. These four principles will have the greatest impact in the development of changes to policy on the Agency and for applicants in enhancing resiliency and in providing supplement disaster assistance.

## **A. A BRIEF REVIEW**

Existing law, regulation, and policy provides the core of the guidance on insurance in FEMA's Public Assistance program. The Robert T Stafford Act provides the law. Sections 311 and 312 in the Stafford Act provide the direction and guidance. Section 311 provides congressional guidance on insurance.<sup>323</sup> Section 312 provides guidance on the duplication of benefits.<sup>324</sup> Section 406 provides guidance on the repair, restoration, and replacement of damaged facilities and guidance on insurance considerations related to that function.<sup>325</sup> The 44 Code of Federal Regulations (CFR) provides the more refined guidance for implementation of the law and regulation of insurance under the Public Assistance program. Sections § 206.250 through § 206.253 provide the guidance on insurance for flood and other than flood events, respectively.<sup>326</sup> Policy on insurance is provided by the Public Assistance Guide, Public Assistance Digest, and Disaster Assistance Policy 9580.2, which provides 'Guidance for Field Personnel on Insurance.' Lastly, Disaster Assistance Policy 9580.3 had provided the FEMA policy on the insurance with respect to deductibles and apportionment of eligible and ineligible insurance proceeds in addition to other insurance considerations restated from other documents.<sup>327</sup>

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<sup>323</sup> The Stafford Act, Section 311.

<sup>324</sup> *Ibid.*, Section 312.

<sup>325</sup> *Ibid.*, Section 406.

<sup>326</sup> 44CFR, § 206.252 and § 206.253.

<sup>327</sup> Federal Emergency Management Agency, Disaster Assistance Policy 9580.3, May 2008.

However, the May 2008 fact sheet was rescinded on February 8, 2013.<sup>328</sup> While the FEMA policy on insurance is under review, the recession leaves the current guidance in question on the eligibility of deductibles in a subsequent event.

The critical component and core issue related to insurance as related to FEMA's Public Assistance program is ensuring state and local governments are protected from damages today and more resilient for disasters tomorrow. The insurance implementation addressed in this document attempts to implement those principles and the intent of Congress as delineated in the Stafford Act.

## **B. THE FOUR KEY PILLARS OF INSURANCE**

The existing law, regulation, and policy on insurance provide direction and guidance to FEMA, the state, tribal, and the local jurisdictions. However, these documents are outdated and not clear in their direction and guidance. The current law, regulations, and policy do not promote sound risk management or efficient insurance coverage decision-making in order to support cost effectiveness and efficiency for the facility, the state, FEMA, and the taxpayer.

The Department of Homeland Security's Office of Investigator General agrees in recent publications that the Stafford Act encourages states and local governments to obtain and maintain insurance. However, FEMA's program provides a disincentive to carry insurance and is silent on several important policy issues.<sup>329</sup> The Public Assistance program reimburses applicants in the first disaster regardless of insurance coverage, which provides a disincentive to carry insurance. In the second and subsequent events, applicants are required to obtain and maintain insurance coverage in the amount of the eligible disaster assistance. Current policy does not provide clear guidance on deductibles.

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<sup>328</sup> Deborah Ingram, "Disaster Assistance Fact Sheet 9580.3, Insurance Considerations for Applicants," Letter of February 8, 2013.

<sup>329</sup> Beard FEMA's Process for Tracking Public Assistance Insurance Requirements, 1.

Applicants are reimbursed for deductible amounts in insurance policies, regardless of the amount of the deductible thus providing a disincentive for a small or moderate deductible.<sup>330</sup>

The Public Assistance program as related to insurance should be shaped to promote resiliency and sound practices of risk management in order to reduce the reliance on federal support following a major disaster. The program should be shaped in order to provide incentives and disincentives for insurance coverage that do not create a moral hazard in decision making to applicants or in the federal policy of insurance. Communities should have incentives to recover faster from the first event in order to increase community resilience and risk control measures. And, the taxpayer's federal investment in a facility damaged must be protected in a second event and subsequent event.

The Stafford Act addresses six important provisions as related to insurance. These provisions must shape policies related to insurance in the Public Assistance program.

- The intent of Congress with respect to insurance as defined in the Stafford Act is to encourage individuals and governments to protect themselves by obtaining insurance to supplement or replace government assistance;<sup>331</sup>
- The intent of Congress is to encourage hazard mitigation to reduce losses from disasters;<sup>332</sup>
- A requirement to obtain and maintain insurance as a condition of receiving Public Assistance grant funding;<sup>333</sup>
- A prohibition on duplication of disaster assistance benefits (from any source, including insurance proceeds);<sup>334</sup>

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<sup>330</sup> Beard, "FEMA's Process for Tracking Public Assistance Insurance Requirements," 11.

<sup>331</sup> The Stafford Act, Section 101.

<sup>332</sup> Ibid.

<sup>333</sup> Ibid., Section 311(b).

<sup>334</sup> Ibid., Section 312.



- Deductions from grant funding for certain uninsured facilities located in an SFHA;<sup>335</sup> and
- FEMA shall not require greater types and extent of insurance than are certified to him as reasonable by the appropriate State Insurance Commissioner responsible for such insurance.<sup>336</sup>

These provisions are the primary issues in law and are the core of the insurance issues in order to improve guidance as related to FEMA's Public Assistance Program. Any revisions in the policy of insurance must adhere to these provisions and promote, enforce, and incentivize these components of law.

These six key provisions must shape the insurance policy in order to comply with the intent of Congress and the adherence to law as related to insurance. Building on these provisions, recommendations to a change in policy include the requirement of insurance, flexibility on the types of insurance policies, insurance deductibles, and promote resiliency and mitigation of future damages, which relates closely to insurance issues and resiliency of communities.

FEMA's insurance policy for the Public Assistance program should consider affordability, adequate insurance, fairness, while promoting flexibility to the applicant and risk management decisions that are not based on the moral hazard of insurance or federal policy. The revision of regulation and policy will correct these deficiencies and create overall guidance that promotes effective management for the facility owner and the taxpayer.

The following four pillars, or principles, are the foundation of the recommendations to improve the guidance on insurance considerations as related to FEMA's Public Assistance program.

## **1. Pillar One: Requirement of Insurance**

The first pillar is the requirement of insurance. This is pillar most difficult to address. Current law and regulation only require insurance for structures

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<sup>335</sup> The Stafford Act, Section 406(d).

<sup>336</sup> Ibid., Section 311(a)(2).

located in a Special Flood Hazard Area for greater than one year and those structures that have received disaster assistance from a previous event. In the first event, current law and regulation does not require a facility owner to have insurance for flood perils, when located outside of a Special Flood Hazard Area, and other than flood perils. Consequently, the law does not promote sound insurance practices and risk management as all facilities are not required to have insurance to adequately protect themselves.<sup>337</sup> While the Stafford Act does not require facility owners to have insurance in the aforementioned circumstances, the intent of Congress is to encourage governments to protect themselves by obtaining insurance to supplement or replace government assistance.

Insurance is required after the first event up to the amount of eligible federal disaster assistance as a condition of the grant that was provided in the first event. This is the obtain and maintain requirement and would represent the federal investment in a facility damaged as a result of an event of the severity and magnitude to receive a presidential disaster declaration. Under current regulation, the facility owner is somewhat rewarded for poor or “passive” management of risk for a facility damaged by an event that resulted in a Presidential declaration. The Stafford Act clearly addresses the supplemental nature of federal assistance and the intent of Congress.

***a. Lack of Consideration for Insurance in the First Disaster***

The Stafford Act assistance is intended to be supplemental in nature. The spirit of the Act would require that a facility owner insure structures for either flood or other than flood events. Insurance is the first source of funding for repair or replacement of a facility and federal disaster assistance supplements any shortfalls in presidentially declared disasters.

The Stafford Act provides guidance for insurance in the first event for facilities located in a SFHA. While the facility owner is not required to purchase insurance, a deduction for the maximum amount of insurance available

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<sup>337</sup> The Stafford Act, Section 406(c)(1).

is mandated for flood hazards. The law does provide a grace period of one year to allow the facility owner to adapt to changes in the Special Flood Hazard Area. This grace period allows for flood map revisions and some leeway for a facility affected by changes to a Special Flood Hazard Area. For flood events, the amount of insurance available through the National Flood Insurance Program is \$500,000 per facility minus a \$1,000 or \$2,000 deductible. An additional \$500,000 of insurance is available for building contents with a similar deductible.

The law is silent on the requirement for insurance for hazards other than flood. The law only encourages insurance to supplement or replace government assistance. Current practice is for FEMA to reimburse for damages from the first event regardless of insurance. For example, a reduction would be made for insurance proceeds, if any, but the full extent of the eligible damages would be reimbursed to the facility owner of the facility did not have any insurance. A facility owner, certainly, would be at risk for damages caused from event without a Stafford Act declaration. The requirement of insurance would correct this reliance on the taxpayer for a reasonable amount of insurance or a reduction of insurance to align insurance requirements with flood and other than flood events regardless of a Stafford Act declaration. Defining a reasonable amount of insurance is difficult and was attempted in February 2000 by FEMA through the Advance Notice Rulemaking Process.<sup>338</sup> For events other than flood, reasonable would need to consider the value of the building and a reasonable deductible through self-insurance or an insurance provider. Additionally, the determination of reasonable would need to consider the State Insurance Commissioner, who has the authority in the determination of reasonably adequate, available, and necessary as delineated by the Stafford Act.

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<sup>338</sup> FEMA, "Disaster Assistance: Insurance Requirements for the Public Assistance Program," 2000.

**b. *Several Options Exist as to Establishing a Requirement of Insurance***

(1) Option 1: No change in policy. Do not establish a requirement of insurance in a first event. The only requirement of insurance is for facilities located in a SFHA for greater than one year.

(2) Option 2: Determine the insurance that is reasonably available by establishing a review panel of insurance experts, insurance brokers, and/or the State Insurance Commissioner. This review panel would make an after-the-fact determination of the insurance that would have been reasonably available prior to the declared disaster.

(3) Option 3: Establish a National Insurance Pool funded for facilities that do not have insurance.

(4) Option 4: Establish federal guidelines for a minimum level of insurance required before disaster assistance would be provided. Regulation would dictate the types and extent of insurance coverage required.

(5) Option 5: Require the states to establish state guidelines for a minimum level of insurance required before federal disaster assistance would be provided. The requirement would include the types and extent of insurance coverage necessary to before receiving federal disaster assistance.

**c. *Considerations of the Requirement for Insurance***

Several factors come into consideration on how to best require insurance or if there should be a requirement of insurance in the Public Assistance program. While the Stafford Act requires only encouraging insurance protection, the Act is designed for supplemental assistance. Federal policy should provide incentives for insurance and disincentives for the lack of such protection.

Requiring insurance across the nation is difficult as our country is very diverse in costs, risks, and perils that impact the local communities. In addition, federal insurance policy should not drive a “minimum standard” as not to alleviate or impede a facility owner’s responsibility for making sound risk management decisions. Federal policy development must not undermine the private insurance markets.

In February 2000, FEMA proposed revised insurance requirements for the Public Assistance Program. In the Federal Register Notice, FEMA proposed the policy standards in Table 16.

<b>Categories of Insurance</b>	<b>Individual Building by Building Policy</b>	<b>Blanket Policy</b>
ALL-RISK	Minimum of 80% Replacement Cost Value (RCV)	Minimum of 80% RCV, or 110% of the total building value at the applicant's highest-valued single location.
EARTHQUAKE	35% of total building value of \$1M or less; 25% of the next \$9M of building 20% of the building value over 20% of the building value over \$10M, with a maximum coverage limit of \$125 M.	35% of the total insurable building values of \$1M or less; 10% of the next \$9M building Value; 5% of the building value over maximum coverage limit of \$125M.
FLOOD	Maximum offered by NFIP per Building.	Total limit equal to or greater than the combined total limits obtained Under separate NFIP policies.
WIND	Minimum of 80% of its insurable Value up to \$125M	Not less than 80% of the total insurable values at the applicant's highest-valued single location up to \$125M.

Table 16. FEMA proposed revised insurance requirements for the Public Assistance Program (from Federal Register, “Disaster Assistance: Insurance Requirements for the Public Assistance Program,” No. 36, February 23, 2000)

While the feedback, especially of applicants in earthquake prone areas, was negative, the ANPR did attempt to define a minimum level of insurance.

The current practice is “the first bite is free” with respect to insurance and any obtain and maintain insurance requirement would pertain to a second or subsequent declared disaster. Facility owners are rewarded for no insurance; whereas, insured facility owners are making premium payments in order to appropriately protect themselves. The requirement of a minimum level of insurance would alleviate this lack of protection and reliance on the taxpayer. If a facility owner sustained damage in a first event without complying with the minimum level of insurance, they would receive disaster assistance only in the amount that exceeds the minimum level of required insurance. This would parallel the requirement of insurance for facilities located in a SFHA for greater than one year.

The disaster assistance programs in Australia and Canada lead to other options in the requirement of insurance. These countries will reimburse facility owners for damages for uninsured facilities in the first disaster based on a requirement to protect themselves by obtaining insurance through an assessment or deduction of available insurance. Australia and Canada make adjustments for uninsured facilities based on what was reasonably available (Canada) or based on the approval an insurance assessment (Australia).

Several options exist in the requirement of insurance. Each of these options has many implications in the implementation of a policy as related to the Public Assistance program. These options on the surface are quite simple. Facility owners either have some type of insurance coverage providing risk protection or have chosen to retain that risk. In this case, the retention of risk is either through self-insurance or has made the choice not to insurance. The decision to insure is the decision not to retain the risk of a loss to the facility; whereas a facility owner’s decision to self-insure is deciding to retain the risk of a loss to the facility. The lack of insurance is in fact a decision on insurance. The taxpayer should not be subject to facility owners risk retention decision-making.

The options on the requirement of insurance have many considerations. The law, regulations, and policy should provide incentives and disincentives for facility owners in making sound insurance decisions.

(1) Option 1: No Change to Existing Policy. The lack of change to the current policy would not be recommended, as the current policy does not encourage insurance as intended by the Stafford Act. The current practice is “the first bite is free” with respect to insurance and any obtain and maintain insurance requirement would pertain to a second or subsequent declared disaster. Currently, facility owners are rewarded for no insurance; whereas, insured facility owners are making premium payments in order to protect themselves are penalized for appropriately managing risk.

(2) Option 2: Determine the insurance that is reasonably available by establishing a review panel of insurance experts, insurance brokers, and/or the State Insurance Commissioner.

This review panel would make the determination of the insurance that would be reasonably available. As in Canada, the Disaster Financial Assistance Arrangements define the role of insurance in the disaster assistance program and insurance coverage for a specific hazard is determined jointly between Public Safety Canada Regional Director and the province.<sup>339</sup> Any necessary professional advice can be obtained through the insurance bureau of Canada or a regional insurance broker. If insurance is only available for up to a designated fraction of the appraised value of the building, some portion of the uninsured loss may be eligible for disaster assistance.<sup>340</sup> Conversely, for facility owners that do not carry insurance, only the losses for which they could not have obtained insurance at a reasonable cost will be

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<sup>339</sup> FEMA, “Guidelines for the Disaster Financial Assistance Arrangements,” 2007, 14.

<sup>340</sup> Ibid., 27.

eligible.<sup>341</sup> This would ensure equal treatment with those who had insurance coverage.

In practice in the US, the after-the-fact review could be accomplished with the appropriate review panel that would need to be established in concept prior to the event with identification of those on the review panel. The broad backgrounds of the review panel would provide the appropriate expertise to make such a determination. The review panel would need to be expeditious in their decision making as to not slow recovery of the facility and the community. However, as the panel is making an after-the-fact judgment, this panel and its decision making authority would be very contentious and prone to great debate over insurance that was reasonably available. On the other hand, a “last resort” option of the review panel would encourage facility owners to define their insurance protection pre-event as to avoid such a review panel.

Alternatively, FEMA Regional Offices could determine a historical average of insurance coverage that was maintained by similar facility owners. This average could be used as a benchmark of available insurance. The benchmark would be used in making the reduction of insurance that was reasonably available to facility owners. Any damages to the facility above the benchmark would be eligible for assistance.

(3) Option 3: Establish a National Insurance Pool funded for facilities that do not have insurance. Several examples of similar programs have been addressed in previous chapters where insurance is not readily available. The first is the National Flood Insurance Program (NFIP). This program provides a minimum standard of coverage to all facilities purchasing flood insurance across the country. A “standard” approach to insurance of public facilities is not manageable due to diverse needs, protection requirements, risk management, and available insurance through the insurance markets.

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<sup>341</sup> Ibid.



The second example is the Price Anderson Act requires the owners of nuclear facilities to participate in the insurance pool program. This program provides insurance to similar facilities across the country where private insurance is not readily available. The three levels of protection offer a risk sharing pool with participation of a minimum level of insurance at the facility level, a risk pool shared across all nuclear facilities across the nation, and then supplemental assistance at the federal level as the third level of protection.

The third example is Australia is exploring a national road pool insurance program. This is, again, a type of facility where private insurance is not readily available. The funding of such a pool of roads is in a high level of concept development and many questions are still being answered including whether the risk sharing model would be funded pre or post event.

The national pool of insurance would not be palatable for a multitude of reasons. The most significant is insurance is available through the private sector. In addition, the implementation of such a program would be cumbersome and such a program would be extremely difficult to design in order to meet the needs of jurisdictions across the country. If the national pool included only uninsured facility owners, funding questions would arise as to pre-funding the pool or funding post-event. These are complex questions as to the viability of such a national pool of uninsured facility owners. Again, and most importantly as to the viability of a national pool, insurance is readily available through the private sector.

(4) Option 4: Establish federal guidelines for a minimum level of insurance required before disaster assistance would be provided. The difficult component of requiring insurance is allowing the facility owner to make insurance decisions irrespective a federal policy. This is to avoid the moral hazard of the insured where they would have less incentive to take fewer precautions because of the existence of a federal policy. If the insurance regulation and policy establishes a minimum level of types and extent of insurance, facility owners will not exceed the “floor” set by federal policy even

though exceeding the floor due to the risks of the community may be the prudent decision. In addition, a federal standard could undermine the insurance markets in offering risk management solutions. In other words, federal policy should promote facility owner's ability to make sound risk management decisions without regard to federal assistance in the event of a declared disaster. Facility owners will bear the risk of their insurance decisions and should be afforded the opportunity to define the risk they choose to retain or transfer. The requirement of insurance could be met by either an insurance policy or a self-insurance plan in which facility owners define their protection of insurance.

If the minimum standard was required at the state level, the minimum level of protection at the federal level could define a backstop of a minimum requirement. This would be in the event a state has not yet defined such a level of insurance or chooses not to establish a level themselves. This would be a default level of protection. However, an unintended consequence of a default level of required insurance protection would set the minimum insurance coverage required for all public facilities. The default minimum level of protection could be worded in a manner whereas states could lower the minimum level of protection provided the circumstances in the state warranted the reduction. To some degree, this wording would alleviate the unintended consequence of setting a floor of insurance and encourage states to set the required insurance levels.

(5) Option 5: Require the states to establish state guidelines for a minimum level of insurance required before federal disaster assistance would be provided.

The states are better suited to make the determination of a minimum level of insurance. The process of this requirement could be established through the state hazard mitigation plan. Every grantee, which includes all states in addition to all tribes that make the decision to be a grantee, are required to submit a hazard mitigation plan in order to receive hazard mitigation funding and Public Assistance for permanent work. The plan is to

“identify the natural hazards, risks, and vulnerabilities of areas in the state,” which could conceivably include insurance considerations.<sup>342</sup> States are required to submit a hazard mitigation plan every three years and this could be an avenue to address insurance vulnerabilities. While a minimum level of insurance would be defined and approved through this plan, the states would be making that decision of risk, identifying the vulnerability, and the federal government would have an assessment of the risk in the event of a declared disaster. Tribes would be required to include the insurance component in their hazard mitigation plan as well, if the tribe chose to be their own grantee. Otherwise, the tribe would be incorporated into the state minimum insurance requirement.

The minimum level of insurance coverage would be defined by the state. The minimum level of insurance coverage is frequently defined in a percent of value of the facility but also could be defined by a percentage of an annual operating budget or a multitude of other metrics. The Louisiana Insurance Commissioner defines the insurance requirements in a percentage of operating budget for seven types of public organizations.<sup>343</sup> Regardless, of the method, states would be defining the minimum level of protection required which would lead to all facility owners having an insurance policy that meets that minimum or an insurance plan which defines the insurance protection for the facility.

To expand on this option, local hazard mitigation plans could include the same requirement in defining a minimum level of insurance for the jurisdictions included in the plan. Currently, 20,202 communities have FEMA approved local multi-Hazard mitigation plans. Communities and tribes with planned mitigation strategies include 69% of the nation's population. If local hazard mitigation plans included insurance considerations, the minimum level of

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<sup>342</sup> The Stafford Act, Section 322(a).

<sup>343</sup> Governor's Office of Homeland Security and Emergency Preparedness, “Stafford Act: Insurance Commissioner's Certification Process,” May 2013.

insurance would be defined by the jurisdictions in outlining their own risks and vulnerabilities, which is the intention of the plan.

***d. A Layered Approach to Insurance Requirements***

Given the options as to the requirement of insurance, the optimum route may be in a layered approach in order to encouraging facility owners to protect themselves by obtaining insurance to supplement or replace government assistance. The approach which would be the requirement of “encouragement” would be defined as through a multiple step review. First, does the facility owner have an insurance policy or an insurance plan? As previously addressed, the decision to self-insure or have no insurance is a decision to retain the risk of loss to the insurable facility. The insurance plan would need to include the risk financing component of the facility owners risk management portfolio including retained risk, insurance, and noninsurance transferred risk. The local hazard mitigation plan could incorporate the risk management structure of the communities, which would include their insurance requirements for the communities covered by the plan.

Second, does the state have a minimum insurance level? If the insurable facility owner did not have an insurance plan, the minimum insurance level would be defined in the State’s hazard mitigation plan. Third, if the insurable facility owner did not have an insurance plan or chose to self-insure without a plan and the state did not establish a minimum insurance level, an independent review panel would be convened to establish the minimum amount of insurance that was reasonably available to the insurable facility owner.

While a review panel would not be ideal, it would encourage insurable facility owners to have an insurance or risk management plan. Other options for a third level of insurance requirement determination could be a federal standard or, simply, the facility owner would be ineligible for disaster assistance without an insurance plan.

As to provide a disincentive for the lack of insurance given the eligibility of the facility owner in receiving disaster assistance, the failure to have insurance or an insurance plan would result in the existing obtain and maintain requirement for the amount of disaster assistance provided in addition to a reduction of future assistance by limiting the federal share of assistance in the second or subsequent event. The Stafford Act provides the authority for a reduced federal share for facilities that have sustained damage more than once in a 10-year period and the facility owner failed to implement appropriate mitigation measures.<sup>344</sup> The reduced federal share would be not less than 25 percent federal share and 75 percent non-federal. This disincentive would apply to a similar peril that caused the damage. In practice, regulations would need to be drafted to promulgate this regulation to codify the reduced federal share in addition to the obtain and maintain requirement for subsequent events. While the obtain and maintain requirements apply to disaster assistance provided in the first event, the reduced federal share would apply to the facility.

Figure 3 details the insurance decision process in reviewing the insurance at the facility owner level, the state level, and in event of a lack of insurance or a plan.

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<sup>344</sup> The Stafford Act, Section 406(b)(2).

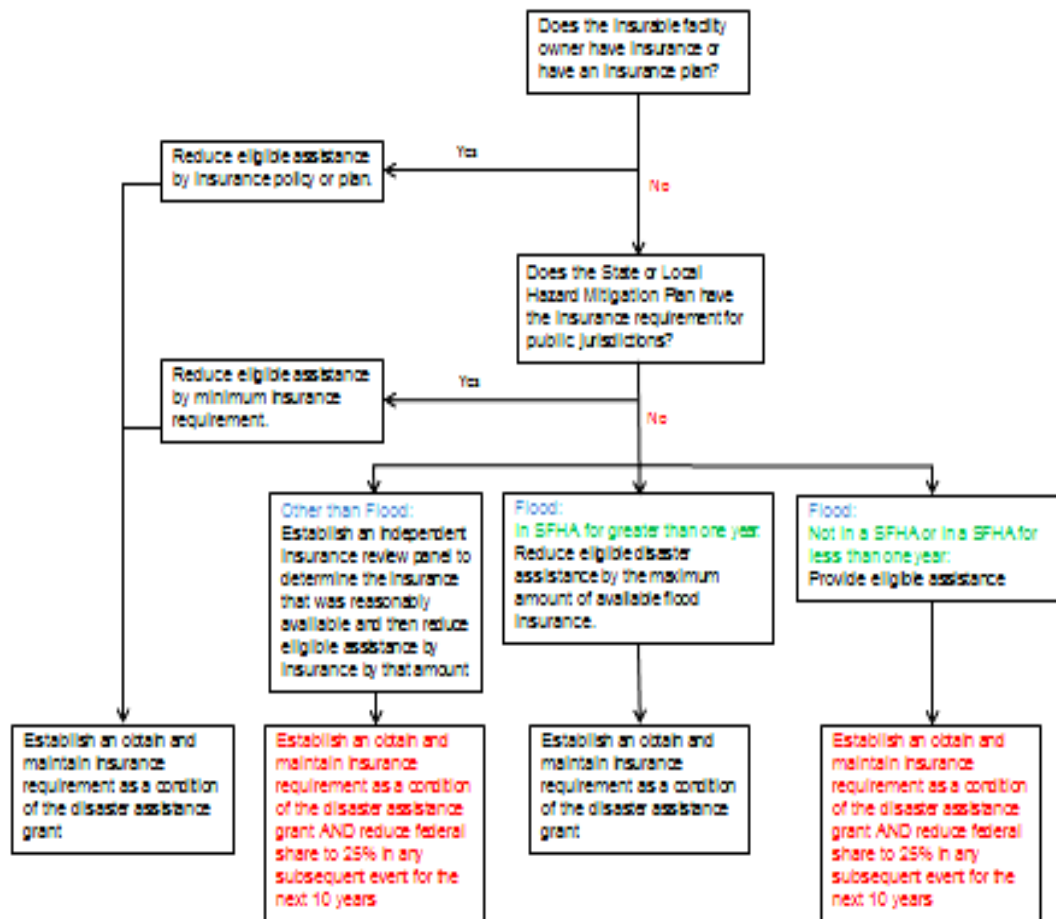


Figure 3. Flow chart of insurance policy

### e. *Implementation*

The Stafford Act addresses the supplemental nature of disaster assistance and encourages facility owners to obtain protection through insurance coverage. Additionally, the Act requires the President to assure such types of extent of insurance will be obtained and maintained.<sup>345</sup> In practice, this provision has been applied as an obtain and maintain requirement on a subsequent disaster. The requirement of insurance is critical to supplemental assistance in the event of declared disaster and establishing minimum level of insurance to

<sup>345</sup> The Stafford Act, Section 311.

best meet this requirement without burdening the applicant with exorbitant insurance premiums is the challenge. The applicant should have the flexibility to manage their own risk in determining insurance requirements without undue burden to the taxpayer. The establishment of regulation in order to “encourage” applicants to be insured or have plan of insurance is within the intent of Congress as defined in the Stafford Act. Regulation in the 44 CFR would have to be promulgated in order to support this encouragement of a having an insurance, an insurance or risk management plan, or a state minimum of insurance. The revision would also need to include the requirement of insurance guidelines in the local and state hazard mitigation plan. In addition, regulation defining the reduced federal share for the lack of an insurance plan would also require drafting.

## **2. Pillar Two: Types of Insurance Policies**

The second insurance pillar is the types of insurance policies available to facility owners. The types of insurance policies currently impact grant funding through the Public Assistance program in several areas of assistance. The consideration of the deductible and satisfying the obtain and maintain requirement.

Section 311 of the Stafford Act requires FEMA to require the facility owner to obtain and maintain insurance on a damaged facility whereas the federal government provided a grant in order to protect against the future loss to such property.<sup>346</sup> Sections § 206.252 and § 206.253 of the 44 Code of Federal Regulations further places a requirement on the facility owner to obtain and maintain such types and amounts of insurance as are reasonable to protect against a future loss to the property from the types of the hazard which caused the major disaster.<sup>347</sup>

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<sup>346</sup> Ibid.

<sup>347</sup> 44CFR, § 206.252 and § 206.253.

**a. *Considerations of the Types of Insurance Policies***

Two primary options exist in the types of insurance policies. These options are whether only states can self-insure or should all jurisdictions be permitted to self-insure. No other restrictions currently exist in law or regulation as to a restriction on the types of protection facility owners obtain.

Currently, only states can self-insure.<sup>348</sup> However, large cities have infrastructure and insurance requirements equal to or greater than some states. This is evident through the annual operating budgets of states and large cities. The ten largest cities in the country have annual operating budgets that exceed that of some states. The annual operating budgets of New York, Los Angeles, and Chicago rank 4<sup>th</sup>, 36<sup>th</sup>, and 33<sup>rd</sup>, respectively, in a list that combines the 50 states and the 10 largest cities in the country.<sup>349</sup> The tenth largest city in the country based on operating budget ranks 57 out of 60 on the same list.<sup>350</sup>

In the Advance Notice Rulemaking Process in 2000, there were several comments which urged FEMA to recognize insurance pools and self-insurance programs by local governments.<sup>351</sup> These comments were supportive in expanding the ability to self-insure beyond states.<sup>352</sup> The comments suggest that there should be specific requirements for self-insurance but, most simply affirm that the self-insurance should be an option. In many cases, the comments highlighted that self-insurance can be a more sensible risk management technique than commercial insurance.

FEMA should not be concerned as to the type of insurance policy (self-insurance, blanket, scheduled, pooled, noninsurance transferred risk, or

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<sup>348</sup> The Stafford Act, Section 311(c).

<sup>349</sup> National Association of State Budget Officers, Summaries of Fiscal Year 2014 Proposed Executive Budgets, March 22, 2013.

<sup>350</sup> Ibid.

<sup>351</sup> Federal Register, "Disaster Assistance; Proposed Insurance Requirements for the Public Assistance Program," February 23, 2000, Volume 65, No. 36.

<sup>352</sup> Ibid.



other arrangement). The facility owner should not be limited in purchasing the types of insurance that best fit the facility owner's risk management requirements. The type of policy is a risk management decision and should be left to the facility owners. FEMA should be only concerned that a facility is protected by insurance, self-insurance, or noninsurance product in the first event and subsequent events in meeting insurance requirements in accordance with insurance protection outlined in local and state hazard mitigation plans and in satisfying obtain and maintain requirements. To best protect the taxpayer's investment, an insurance policy, or self-insurance, would be required to protect the federal investment when grant funding was provided to facility owner and obtain and maintain requirements are a condition of the disaster assistance grant. Flexibility in the types of insurance that can a component of the risk management portfolio is cost effective for the facility owner, the state, the federal government, and the taxpayer.

***b. Implementation***

The Stafford act is silent on types of policies other than self-insurance. The Act allows only states to act as a self-insurer. The law requires states to make such election in writing and submit the election with a plan acceptable to the President.<sup>353</sup> If the election to be a self-insurer would expand beyond states, the law and regulation would require changing to allow facility owners to make such an election. The expansion of the self-insurance election would need to include an approval process for both grantees and subgrantees and a minimum level of expertise. For example, a self-insurer would be required to have a fulltime risk manager and the capacity to satisfy the appropriate management of such an election.

The 44 CFR only addresses blanket insurance policies covering all their facilities, an insurance pool arrangement, or some combination of these options. These type policies, for other than flood, currently limit deductibles after

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<sup>353</sup> The Stafford Act, Section 311(c).

the first as eligible costs will be reduced by the amount of eligible damage sustained on the previous disaster.<sup>354</sup>

For blanket insurance policies covering all their facilities, an insurance pool arrangement, or some combination of these options no change in law or regulation is required. For self-insurance elections, amplifying guidance is also needed to better define the state's election and the approval process and requirements of the plan for self-insurance.

Similar to the discussion in the requirement of insurance, the facility owner should have the flexibility to manage their own risk in determining insurance requirements in a portfolio of risk financing without undue burden to the taxpayer. This includes the ability of the applicant to select the type of risk bearing measures that best fits their needs, which could include components of risk retention, noninsurance transferred risk, and insurance.

### **3. Pillar Three: Insurance Deductibles**

The third insurance pillar is related to deductibles. FEMA's February 8, 2013 memo rescinded Disaster Assistance Fact Sheet 9580.3.<sup>355</sup> While the memo addressed and re-stated several issues involving insurance, the memo has left many questions related to insurance deductibles. The memo permits the reimbursement of second deductibles for all policies except blanket insurance policies. The Stafford Act is silent on deductibles. The law is detailed in Section 311 of the Stafford Act on the treatment of insurance under FEMA's Public Assistance program.<sup>356</sup> Regulation is provided by Sections § 206.252 and § 206.253 of the 44 Code of Federal Regulations. Both sections of the regulation require FEMA to reduce the eligible costs by the amount of insurance proceeds, except for blanket policies, pool arrangements or some

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<sup>354</sup> 44CFR § 206.253(b)(2).

<sup>355</sup> Deborah Ingram, "Disaster Assistance Fact Sheet 9580.3, Insurance Considerations for Applicants," Letter of February 8, 2013.

<sup>356</sup> The Stafford Act, Section 311.

combination.<sup>357</sup> Most would argue that insurance proceeds do not include the deductible, only the “check” provided by the insurance company.

**a. Considerations for Insurance Deductibles**

In practice following a major disaster, FEMA would reimburse the facility owner for damages to an insured facility for the eligible disaster assistance related damages minus the insurance proceeds. The eligible reimbursement to the applicant would include a reasonable deductible, the difference between FEMA eligible costs and insurance valuations, and cost in excess of insurance policy limits.<sup>358</sup> These uninsured losses could include damages that exceed the insurance limit of liability as well as building contents, temporary facilities, deductibles, etc.

With the recession of the Disaster Assistance Fact Sheet 9580.3 as it relates to deductibles, a deductible in a subsequent, similar peril comes into question. The former policy provided guidance that deductibles, up to and including the amount of eligible damages incurred in a previous disaster, are not eligible for the same facility in a subsequent disaster of the same type.<sup>359</sup> Current practice currently guides FEMA to reimburse the applicant for the second deductible for all policy types except blanket policies as defined in the 44 CFR.

Three options exist in the reimbursement of insurance deductibles. Simply, the options are to reimburse for deductibles in all events, reimburse for only the first event, or do not reimburse for deductibles in any event. These options have many implications in the implementation of an insurance policy and the Public Assistance program.

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<sup>357</sup> 44CFR, § 206.252 and § 206.253.

<sup>358</sup> Federal Emergency Management Agency, *Public Assistance Policy Digest*, 2008, 76.

<sup>359</sup> Disaster Assistance Fact Sheet 9580.3, “Insurance Considerations for Applicants,” May 2008, 3.

***b. Considerations of the Reimbursement for Insurance Deductibles***

The Stafford act is silent on deductibles. The regulation provides additional guidance on deductibles. The 44 CFR currently guides FEMA to reimburse the applicant for the second deductible for all policy types except blanket policies.

(1) Option 1: Reimbursement for Insurance Deductibles for all events. The primary argument for the reimbursement of deductibles is the event caused the need to pay the deductible, whether in the first or subsequent event. However, many considerations are involved in the counter argument. Primarily, is the reimbursement of a deductible from a second or subsequent event a duplication of benefits?

(2) Option 2: Reimbursement for Insurance Deductibles only in the first event. The considerations on reimbursing for a second deductible reach much further than the duplication of benefits. While the reimbursement of a second deductible could be considered a duplication of benefits, the assistance the facility owner received for deductible in a previous event is only one of the many considerations in the evaluation deductibles.

In the case where the deductible is the same as the first event, the argument could be made that the event caused the need to pay for the second deductible. However, based on the fact that the insurance company has made a payment on an insurance claim to the facility owner, the insurer will likely raise the insurance premium at the end of the policy period. As a result, the facility owner has a decision to make with respect to the increased premium. The facility owner could: (1) pay the increased premium; (2) negotiate an increased deductible in order to minimize the premium increase or completely eliminate an increase in premium; or (3) negotiate a lower policy limit to eliminate or limit a premium increase. The third option is unlikely as the increased risk to the facility owner above the policy limit would not typically be a sound business practice. Additionally, the lower overall policy limit may not satisfy any obtain and

maintain requirements. The second option is very likely as the facility owner actually incurs very little risk, as FEMA will reimburse for the deductible in a second event following a major disaster declaration. Therefore, the increased deductible for the reduced or stable premium is a very likely course of action for the facility owner. The risk incurred would only be the losses incurred without presidentially declared disaster. Similarly, the considerations in option one are related to balancing risk and policy premiums.

From FEMA's prospective, the increased deductible in the subsequent event is an added risk to the Agency and taxpayer. While the increase in deductible may be a good business practice for the facility owner, the increase in deductible creates questions related to duplication of benefits and reasonableness for FEMA.

The following example reflects the increased deductible in a subsequent event. Table 17 depicts the insurance considerations for a facility with \$100,000 insurance coverage on the structure prior to the damages incurred due to an event that led to a Stafford Act declaration. In the table, the structure has a \$50,000 deductible prior to the first event. In the first event, the deductible (\$50,000) and the damage that exceed the policy limit (\$125,000 - \$100,000 = \$25,000) would be eligible for reimbursement. The total eligible costs would be \$75,000 (\$50,000 deductible + \$25,000 over the policy limit).

Event	Deductible	Eligible Damages	Eligible Costs
First	\$50,000	\$125,000	\$75,000
Second – Same deductible	\$50,000	\$130,000	\$55,000
Second – Increased deductible	\$100,000	\$130,000	\$105,000

Table 17. Insurance deductible considerations for a facility with a \$100,000 limit of liability.

In the second event, the facility owner would have a “obtain and maintain” requirement of \$125,000 from the first event, which would be ineligible in the subsequent event. Therefore, the eligible damages would be the

deductible and eligible costs above \$125,000. As the table indicates, the taxpayer is at risk for the increased deductible.

Similarly, deductibles for catastrophic events (Earthquake, Hurricane, and Flood) are typically a percentage of the policy limit. The most common is 3% of the value of the building with 5% as the maximum. As in the previous example, the facility owner is not increasing their own risk in raising the deductible on the facility following a major disaster. A catastrophic event, earthquake, hurricane, or major flood, would likely trigger a major disaster declaration. Therefore, the facility owners are not greatly increasing their own risk by raising the deductible following a first event as the federal government would assume the risk. Thus, the facility owner is provided even more protection in the eligibility of the second deductible.

Similarly, deductibles for blanket policies are more in line with risk management decisions that the taxpayer should not be financially responsible. Regulation provides unambiguous guidance on deductibles for blanket or pooled arrangements. Current regulation requires eligible costs will be reduced by the amount of eligible damage sustained on the previous disaster.<sup>360</sup> Eligible damage would include the deductible. § 206.253 (b) (2) is a critical component of the ineligibility of deductibles in current program implementation and in the future implementation of insurance in the Public Assistance program. In a blanket, schedule of values, or pooled arrangements of insurance, the deductible, the limitation of insurance for each structure, and the overall policy limit are critical components of risk management. The taxpayer should not bear the burden of these decisions.

Option 3: Insurance Deductibles are not eligible for reimbursement. The deductible is a key component of risk management in the protection of a facility to funding losses to that facility. Specifically, deductible

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<sup>360</sup> 44CFR, § 206.253 (b)(2).

decisions are a component of risk retention by a facility owner. The balance between retained risk and insurance premium is part of the overall risk financing of a facility, which include the deductible and insurance.

While not considered a deductible, self-insurance or self-insurance retention is the same decision-making in retaining risk. While the types of self-insurance may be cost effective, the insured has the responsibility for the retained risk, which may be all or part of the facility value.

There are an endless number of options in determining the optimum deductible, self-insured retention, or self-insurance. However, it is clear that the decision of risk retention is the facility owners in developing a portfolio of risk financing, which includes risk retention, noninsurance transferred risk, and insurance. Federal policy should not discourage sound decision making in managing risk nor should the moral hazard of insurance sway facility owners from making sound risk management decisions.

### ***c.. Implementation***

The Stafford Act is silent on deductibles. The Act does provide the Insurance Commissioner great authority as the “the President shall not require greater types and extent of insurance than are certified to him as reasonable by the appropriate State Insurance Commissioner responsible for regulation of such insurance.”<sup>361</sup> The proposed regulation in this document would not require greater types and extent than deemed appropriate and reasonable by the State Insurance Commissioner. Each facility owner will still be able to retain all the risk or as little of the risk they choose to retain. However, this proposed regulation would make deductibles ineligible for assistance.

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<sup>361</sup> The Stafford Act, , Section 311.

The 44 CFR would also require a change to make deductibles not eligible for disaster assistance. The proposed revised insurance requirements for the Public Assistance Program in February 2000 also addressed deductibles.<sup>362</sup> In the Federal Register Notice, FEMA proposed insurance deductible amounts in Table 18.

#### **Insurance Deductible Amounts**

<b>Categories of Insurance</b>	<b>Individual Building by Building Policy</b>	<b>Blanket Policy</b>
ALL-RISK	0.1% of the building's insurable value with a maximum	0.1% of the building's value with a maximum of \$100,000 per occurrence for all buildings involved.
EARTHQUAKE	Maximum of 7.5% of the insurable value of the building.	Maximum of 7.5% of the insurable value of the building(s).
FLOOD	Maximum of \$1,000.	2% of the total insurable values of the building(s) involved with a maximum of \$25,000.
WIND	Maximum 5% of the insurable value of the building with a maximum value of \$100,000 per occurrence.	Maximum 5% of the total insurable value of the building(s) involved with a maximum value of \$100,000 per occurrence for all buildings involved.

Table 18. Proposed insurance deductible requirements for the Public Assistance Program (from Federal Register, "Disaster Assistance: Insurance Requirements for the Public Assistance Program," No. 36, February 23, 2000)

The Advanced Notice of Proposed Rulemaking (ANPR) again shows the complexity of the implementing a deductible requirement for insurance. The ANPR attempted to balance cost considerations with a minimal standard of sound insurance coverage.<sup>363</sup> Should deductibles continue to be eligible for assistance, a definition of reasonable would be critical in determining

<sup>362</sup> Federal Register, "Disaster Assistance: Insurance Requirements for the Public Assistance Program," Volume 65, No. 36, February 23, 2000.

<sup>363</sup> Ibid.



program implementation in the field. Currently, FEMA reimburses for the deductibles regardless of the size of deductible as reasonable is not defined.

As previously addressed in this chapter, the size of deductible is a risk management decision of how much risk to retain. The supplemental nature of the Stafford Act is clear and deductibles should not be a part of the eligibility in the Public Assistance program.

#### **4. Pillar Four: Resiliency and Hazard Mitigation**

The fourth pillar is to promote resiliency and hazard mitigation. Both are the intent of Congress as delineated in the Stafford Act. However, current regulations need to codify the incentives for hazard mitigation, which will lead to improved resiliency. This can be accomplished in current law but the regulation does not exist. The Stafford Act provides for a reduced federal share for facilities damaged on more than one occasion within a proceeding ten-year period by the same type of event and the owner of a facility has failed to implement appropriate mitigation measures to address the hazard that caused the damage to the facility.<sup>364</sup> The Act allows for the reduction of assistance to not less than 25 percent. Providing an incentive to facility owners to mitigate damages following a first event, the facility and the taxpayer are better protected in a subsequent event and would increase the resiliency of the facility and the community in subsequent events.

Insurance under FEMA's Public Assistance program has three major threads that require an innovative approach in order to protect the federal investment in those facilities due to the major disaster declaration. They are to protect the taxpayer, promote sound risk management decision making, and incentivize cost effective risk management. How to best implement the law and regulation while protecting the taxpayer and providing the greatest amount of

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<sup>364</sup> The Stafford Act, Section 406(b)(2).

assistance to facility owner? A fourth thread in this key component of insurance is increasing the resiliency of communities through the tools available to promote the mitigation of future hazards.

**a. *Community Resilience***

The objective of FEMA's hazard mitigation program is to increase community resilience. FEMA's Public Assistance program must support these same objectives in speeding recovery and increasing community resilience. By evaluating the risk management portfolio pre-event, communities will be less reliant on the federal government for support as communities perceive shortfalls and will be able to mitigate them pre-event. Ultimately, this will speed recovery following either a major disaster declaration or non-Stafford Act event. A community will be able to make risk management decisions based on overall protection of a facility regardless of federal assistance.

**b. *Increased Resiliency Through Hazard Mitigation***

The use of mitigation, as a component of the insurance policy, would greatly increase resiliency in communities through risk control measures. The benefit to the facility owner and the taxpayer is substantial as the vulnerability of a community is reduced in a subsequent event. The Stafford Act provides for a provision for a reduced federal share for facilities damaged on more than one occasion within a proceeding ten-year period by the same type of event and the owner of a facility has failed to implement appropriate mitigation measures to address the hazard that caused the damage to the facility.<sup>365</sup> The Act allows for the reduction of assistance to not less than 25 percent.<sup>366</sup> Providing an incentive to facility owners to mitigate in the first event, the facility and the taxpayer are protected in a subsequent event. While the Stafford Act permits a 25 percent federal share, the federal share should be stepped down

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<sup>365</sup> The Stafford Act, Section 406(b)(2).

<sup>366</sup> The Stafford Act, Section 406(b)(2).

over subsequent events. For example, the first event the federal share would be the normal 75% federal share (or 90% federal share in more catastrophic events consistent with current policy).<sup>367</sup> The second event would be no more than 50% federal share for damages to the same facility for the same type of event. The third event the federal share would be reduced to 25%. Current law provides a requirement for no less than 25% federal share for damages to the facility.

The exception would be for facilities that do not have insurance, an insurance or risk management plan, or a minimum standard in the local or state hazard mitigation plan where the facility would only be eligible for 25% federal share in a second or subsequent event. This component was addressed in the first pillar on the requirement of insurance. Although the incentive is negative, reduced federal assistance in future events is a significant incentive to facility owners to mitigate damages in the first event, which will increase the resiliency of communities and reduce disaster assistance costs.

### ***c. Implementation***

The Stafford Act requires the President to promulgate regulations to reduce federal share of assistance to not less than 25% in the repair, restoration, reconstruction, or replacement of eligible public facility or private nonprofit following an event associated with a major disaster. The two provisions under this authority are for (1) facilities damaged on more than one occasion within the proceeding 10-year period by the same type of event and (2) the facility owner failed to implement appropriate mitigation measures to address the hazard that caused the damage to the facility.<sup>368</sup>

The 44 CFR is silent on addressing this provision in the Stafford Act. The guidance to enact this provision would need to be promulgated through the ANPR.

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<sup>367</sup> The cost share adjustment to 90% federal share is \$133 (FY13) per capita of federal assistance provided in a given state.

<sup>368</sup> The Stafford Act, Section 406(b)(2).

### **C. EFFECT OF THE FOUR PILLARS OF INSURANCE**

The proposed changes may potentially shape the law, regulation, and policy on the role of insurance as related to FEMA's Public Assistance program. We have examined existing law, regulation, and policy and attempted to develop clear direction that promotes sound risk management for the applicant, the state, FEMA, and the taxpayer. The next steps are to evaluate the policy and risk management practices that will benefit the various levels of jurisdictions impacted by disaster with respect to types and extent of insurance required and promote sound risk management practices.

Law, regulation, and policy do not provide precise guidance to implement the insurance portion of the Public Assistance program in the field and protect the federal investment in previously awarded disaster assistance grants for damaged facilities. The imprecise and outdated policy leads to an over reliance on federal support, which leads to promote poor risk management.

The risk management affects the facility owner directly. The policy and strategy of sound risk financing practices also affect the taxpayer, the State Insurance Commissioner, and FEMA. Promoting sound practices in risk management will speed recovery and ultimately lead to communities that are more resilient.

Federal policy should not deter risk managers from sound decision making on the appropriate levels of risk retention, noninsurance transferred risk, and insurance for adequate protection for all their facilities. Only Facility owners can make the right decision on types and extent of insurance based on their specific situation, as well as how much to retain. These decisions would appropriately apply to Stafford Act events and non-Stafford Act events. In addition, the taxpayer would not be liable for poor risk management decisions or moral hazards. The facility owner would rightfully be at risk for their poor decisions and benefit from proper risk management determinations.

The net effect of these changes will likely encourage facilities owners to retain the appropriate risk in deductibles and self-insurance as federal assistance would not be available. The most likely scenario would be facility owners retaining less risk with lower deductibles. While the limit of liability of insurance policies across the country may change, insurance requirement and risk management profiles defined in state and local hazard mitigation plans will assist in defining the risk that the federal government faces as the provider of last resort. The likely scenario would be a lower limit of liability. However, by defining this risk in a transparent manner, we as a nation can begin to explore alternate measures to expand our risk bearing capacity to support a catastrophic event.

#### **D. LAW AND REGULATION CHANGES OF THE FOUR KEY PRINCIPLES OF INSURANCE**

The four pillars addressed in these recommendations require different levels of changes to law and regulation. Of the different components to promote sound insurance practices under the FEMA's Public Assistance program, the overall insurance requirement is the most difficult to implement. While the Stafford Act could support the requirement of insurance in its current form, the regulation would need revision to support such a requirement. The types of insurance policies and obtain and maintain requirements are under review but would require changes to existing law and regulation. The consideration of deductibles (or lack of) also requires changes to regulation. The hazard mitigation requirement would also require development to existing regulation.

##### **1. Recommended Changes in Law—The Stafford Act**

The primary recommended changes to Stafford Act would be to expand the ability for local and nonprofits to self-insure. This change is relatively simple changing state to applicant will allow for all applicants to act as a self-insurer. The changes to regulation would need to address the requirement for a non-grantee applicant to make the self-insurance election with the accompanying

plan for self-insurance, which is satisfactory to the President, through the appropriate grantee. The changes are represented in red and italics.

Section 311. Insurance (42 U.S.C. 5154)

(c) *Applicant* acting as self-insurer - An *applicant* may elect to act as a self-insurer with respect to any or all of the facilities owned by the *applicant*. Such an election, if declared in writing at the time of acceptance of assistance under section 5172 or 5189 of this title or section 3149(c)(2) of this title) or subsequently and accompanied by a plan for self-insurance which is satisfactory to the President, shall be deemed in compliance with subsection (a). No such self-insurer may receive assistance under section 5172 or 5189 of this title for any property or part thereof for which it has previously received assistance under this Act, to the extent that insurance for such property or part thereof would have been reasonably available.

The Stafford Act will support all other recommended changes. However, clarifying the requirement of insurance and the ineligibility of deductible would assist in formalizing those changes, but are not required. These changes could be promulgated in regulation.

The law changes are the most difficult to implement and do not have a timeline. Changes to the Stafford Act require support of Congress in order to enact. Until that time, only states elect to act as a self-insurer with respect to facilities owned by the state. However, allowing facility owners the flexibility to self-insure benefits almost all the communities across the country.

## **2. Recommended Changes to Regulations—44 Code of Federal Regulations**

The changes to regulation will require a significant change to 44 CFR § 206.251, § 206.252 and § 206.253. The sub-sections below highlight the changes needed to support these recommendations, which are represented in red and italics.

(a) 44 CFR § 206.251

This section of the regulation is definitions related to insurance. This section should be updated and expanded to include define terminology contained within the interim rule and the recommended changes. The definitions in the existing section § 206.251 are not included. Only the addition definitions are addressed.

**Blanket Policy** – A blanket policy is any insurance contract that contains multiple facilities in a single insurance policy, which could include blanket policies or schedule of value insurance policies. A blanket policy will have a deductible and a limit of liability applying to multiple facilities. Conversely, a non-blanket policy will have a deductible and limit of liability that apply singularly to each facility and the deductible and limit of liability is not pooled in aggregate or a combination of the deductibles or limit of liabilities is not less than total of the two components. Blanket insurance is not permitted under the NFIP.

**Deductible** - A deductible is provision by which a specified amount is subtracted from the total loss that otherwise would be payable. A deductible is the amount of policy coverage that a policyholder must pay as a condition of receiving payment for a covered claim.

**Noninsurance Transferred Risk** – Transfer of risk on a grantees or sub grantees facilities to another party, other than an insurance company. Transferred risk could include risk pool arrangements, catastrophe bonds, or any other mechanism that diversifies risk to a noninsurance company.

**Retained Risk** – Grantees or sub grantees may wish to retain and finance some or all of its risks. Such decisions could include a deductible, self-insured retention, or self-insurance.

**Risk Pool Arrangement** - An insurance risk pool arrangement is an agreement among a group of entities to pool their resources to jointly fund a deductible for the group of properties they own. For example, multiple school districts could form a pool under a state statute to jointly purchase insurance or re-insurance with a high deductible covering all of their facilities; the deductible is funded jointly by the pool members in the event of damage to any of the covered facilities.

Self-Insured Retention – Self-Insured Retention is an amount of the insured risk which the insured agrees to retain before the insurance company's indemnity obligation commences.

Self-Insurance - Self-Insurance is planned retention of risk where all or part of a given loss is retained by the grantee or subgrantee.

(b) 44 CFR § 206.252 (Facilities damaged by flood) and 44 CFR § 206.253 (Facilities damaged by other than flood)

The requirement for insurance or an insurance reduction for other than flood events will require regulation changes to codify the requirement.

The types of insurance policies will require changes to the Stafford Act prior to implementation. Once the changes are made to allow applicants to act as a self-insurer, the regulation would have to be promulgated.

The ineligibility of a subsequent deductible will have to be codified in regulation as well.

The Stafford Act requires the President to promulgate regulations on the reduction of federal share in subsequent, similar events.<sup>369</sup> These regulations need to be promulgated before the federal share reductions could be made.

As a result of these recommendations, the 44 CFR § 206.252 (Facilities damaged by flood) should be updated to reflect these regulations:

44 CFR § 206.252 and 44 CFR § 206.253 should be combined for better understanding;

(a) Requirement of Insurance or an Insurance plan for all applicants that own insurable facilities (buildings, building contents, vehicles, etc)

(1) Insurance plan will address retained risk, noninsurance transferred risk, and insurance. In addition the insurance plan will comply with the requirements of § 75.11. The insurance plan will address the shortfall between maximum risk protection and total insurable assets.

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<sup>369</sup> The Stafford Act, Section 406(b) (2).



(2) Grantees, and subgrantees submitting a hazard mitigation plan, must address the minimum levels of insurance in their hazard mitigation plan for jurisdictions included in the plan.

(3) Self-Insurance – Grantees and sub grantees may act as self-insurer provided the election is made in writing and accompanied by a plan for self-insurance which is satisfactory to the President. In addition, sub-grantees self-insurance plan must be found satisfactory to the appropriate grantee prior to submission to the Regional Administrator.

(4) In effort to comply with the requirement of having insurance or an insurance plan, the grantee or subgrantee shall to notify the Regional Administrator of any entitlement to insurance settlement or recovery for such facility and its contents, the grantee or subgrantee is required to submit the insurance plan for review. If the grantee or subgrantee does not have an insurance plan or insurance, assistance shall be reduced by the amount of insurance that would have been available in compliance with minimum level of insurance in the appropriate hazard mitigation plan. The amount of the reduction shall be the maximum amount of the insurance which would have been received had the building and its contents been fully covered by the minimum standard. If the grantee or subgrantee has not established a minimum standard of insurance in the guiding hazard mitigation plan, the reduction will be based on a review established by the Regional Administrator in determining the insurance that would have been reasonably available.

(b) Deductibles and retained risk are not eligible for disaster assistance.

(c) The grantee or subgrantee is required to obtain and maintain insurance for all perils in the amount of eligible disaster assistance, as a condition of receiving Federal assistance that may be available,

(1) Obtain and maintain requirements are effective no later than 90 days after the repair, restoration, reconstruction, or replacement of any eligible public facility or private nonprofit facility is complete, when the project worksheet is finalized, or at the end of the period of performance, whichever occurs first.

(2) When the Regional Administrator acknowledges the requirement of obtaining and maintaining insurance based upon the State Insurance Commissioner's certification, the certification, in its

entirely, is only effective until the next disaster declaration where the previously damaged facility sustains damage.

(3) The grantee shall provide assurances that the required insurance coverage will be maintained for the anticipated life of the restorative work or the insured facility, whichever is the lesser.

(4) No assistance shall be provided under section 406 of the Stafford Act for any facility for which assistance was provided as a result of a previous major disaster unless all insurance required by FEMA as a condition of the previous assistance has been obtained and maintained.

(d) Reduced federal share – In accordance with Section 406 of the Stafford Act, the Regional Administrator shall reduce the federal share of assistance in the case of the repair, restoration, reconstruction, or replacement of any eligible public facility or private nonprofit facility following an event associated with a major disaster -

(A) that has been damaged, on more than one occasion within the preceding 10-year period, by the same type of event; and

(B) the owner of which has failed to implement appropriate mitigation measures to address the hazard that caused the damage to the facility.

The federal share of assistance shall be 50% for the facility damage by same type of event a second time in the preceding 10-year period. If the facility should be damaged a third or subsequent event of the same type, the assistance shall be 25% federal share for the facility. Insurable Facilities that did not have insurance, an insurance plan, or the appropriate insurance in accordance with the applicable hazard mitigation plan will only be eligible for 25% federal share in the second event of the same type.

(d) For Facilities damaged by Flood:

(1) Where an insurable building damaged by flooding is located in a special flood hazard area identified for more than one year by the Administrator, assistance pursuant to section 406 of the Stafford Act shall be reduced. The amount of the reduction shall be the maximum amount of the *insurance proceeds that* would have been received had the building and its contents been fully covered by a standard flood insurance policy.

(2) The reduction stated above shall not apply to a PNP facility which could not be insured because it was located in a community not participating in the NFIP. However, the provisions of the Flood Disaster Protection Act of 1973 prohibit approval of assistance for the PNP unless the community agrees to participate in the NFIP within six months after the major disaster declaration date, and the required flood insurance is purchased.

(3) Prior to approval of a Federal grant for the restoration of a facility and its contents which were damaged by a flood, the grantee shall notify the Regional Administrator of any entitlement to an insurance settlement or recovery. The Regional Administrator shall reduce the eligible costs by the amount *of eligible damage on the previous disaster.*

(4) The grantee or subgrantee is required to obtain and maintain flood insurance in the amount of eligible disaster assistance, as a condition of receiving Federal assistance that may be available. This requirement also applies to insurable flood damaged facilities located outside a special flood hazard area when it is reasonably available, adequate, and necessary. However, the Regional Administrator shall not require greater types and amounts of insurance than are certified as reasonable by the State Insurance Commissioner. The requirement to purchase flood insurance is waived when eligible costs for an insurable facility do not exceed \$5,000.

(e) For Facilities damaged by other than Flood:

(1) Prior to approval of a Federal grant for the restoration of a facility and its contents which were damaged by a disaster other than flood, the Grantee shall notify the Regional Administrator of any entitlement to insurance settlement or recovery for such facility and its contents. The Regional Administrator shall reduce the eligible costs by the actual amount of *insurance or transferred risk* relating to the eligible costs.

(2) Assistance under section 406 of the Stafford Act will be approved only on the condition that the grantee obtain and maintain such types and amounts of insurance as are reasonable and necessary to protect against future loss to such property from the types of hazard which caused the major disaster. The extent of insurance to be required will be based on the eligible *assistance* that was incurred to the damaged facility as a result of the major disaster. The Regional Administrator shall not require greater types

and extent of insurance than are certified as reasonable by the State Insurance Commissioner.

(3) Due to the high cost of insurance, some applicants may request to insure the damaged facilities under a blanket insurance policy covering all their facilities, an insurance *risk* pool arrangement, *or some other mechanism to transfer risk*. Such *arrangements* may be accepted for other than flood damages. However, if the same

facility is damaged in a similar future disaster, eligible costs will be reduced by the amount of eligible damage sustained on the previous disaster.

(4) The Regional Administrator shall notify the Grantee of the type and amount of insurance required. The grantee may request that the state Insurance Commissioner review the type and extent of insurance required to protect against future loss to a disaster-damaged facility, the Regional Administrator shall not require greater types and extent of insurance than are certified as reasonable by the State Insurance Commissioner.

(5) The requirements of section 311 of the Stafford Act are waived when eligible costs for an insurable facility do not exceed \$5,000. The Regional Administrator may establish a higher waiver amount based on hazard mitigation initiatives which reduce the risk of future damages by a disaster similar to the one which resulted in the major disaster declaration which is the basis for the application for disaster assistance.

The regulation change can be accomplished with public notice and comment periods through the established process. The Sandy Recovery Improvement Act of 2013 allows for flexibility on the public notice and comment period and allows the FEMA Administrator to implement programs as a pilot program. However, based on the sweeping change in the requirement of insurance, the public notice and comment period may be the best course of action.

The regulation changes are implemented through the Advance Notice Rulemaking Process. Complex changes like the insurance changes being recommended will take years to adapt. However, the changes will result in a policy that is clear and field teams can implement in support of the applicants.

## **E. IMPLEMENTATION OF THE FOUR PILLARS OF INSURANCE**

The four pillars of the insurance regulation and policy should be implemented simultaneously as the process involves the Advance Notice Rulemaking Process as defined in the Federal Register. While difficult and lengthy, the changes in regulation must be revised in the 44 CFR in order for the revisions to be implemented in FEMA's Public Assistance program. The rulemaking proposal and comment periods must be navigated as part of the regulation revision and will require an estimated one year of effort in order to successfully make the changes to the 44 CFR. All four principles require changes to the existing regulation to be enacted and to piecemeal the same process could quadruple the implementation timeline. Fortunately, minimal changes are required in the law and, as a matter of fact, the revisions to the 44 CFR more closely align law and regulation.

The first step is already underway with the establishment of an insurance working group to provide analysis of data and review the law, regulation, and policy. Additionally, this step includes drafting the regulation and policy.

The second step will be to establish a consensus within the Agency. Currently, FEMA's policy is interpreted inconsistently across all regional offices and headquarters. The Office of Response and Recovery and Office of Chief Counsel will need to buy into the revised policy before the Advance Notice Rulemaking Process can begin. A series of discussions through the senior Public Assistance staff, the regional offices, and the office of chief counsel will build towards briefing senior FEMA leadership.

The third step will be to engage the Public Assistance Committee within the National Emergency Management Agency (NEMA). NEMA is the association of state emergency managers, specifically the state emergency management directors. Their input will be important in the implementation of the regulation. Additionally, their concurrence and education are important in briefing both law makers and the full NEMA organization. FEMA's senior program leadership

already has a close relationship with this NEMA and this discussion will be a part of normal communication between the two organizations.

The fourth step will be to brief congress. The House and Senate Homeland Security Council's should fully understand the regulation and policy revision's before the Advance Notice Proposed Rulemaking process can start. As the change to regulation and policy is significant, being ahead of the information flow with Congress will be critical to successfully implementing the changes. Because the changes to the law allow for increased flexibility to applicants and the revised policy is more consistent with the intent of the Stafford Act, lawmakers should not have major objection to the changes. The delegations with recent catastrophic disasters will have the most objections as their states will be most impacted. However, all states have cities and state agencies that will benefit from the ability to self-insure which is already occurring in some jurisdictions and is inconsistent with current policy. The ability to self-determine the types of insurance policies gives the states and cities more flexibility in evaluating their own insurance needs. This benefit will be important to emphasize in briefing Congress. The other principles of the program will require more explanation of how the revisions align law and regulation. The benefits to the taxpayer and the ability of jurisdictions to control their own risk management decisions are the most significant component of the revisions and will need to be stressed. Fiscal conservative leaders ideally are an advocate as their views of the law are consistent with this regulation revision. Additionally, they will be receptive to the fiscal accountability in the four pillars of insurance regulation revision. Lawmakers will be also interested in the fact that the regulation is more in line with the law and the intent of Congress.

The fifth step is to brief state emergency management officials and the National Emergency Management Agency (NEMA) on the revision. Understanding the regulation changes and why they will be important to implementation is the key to success in gaining support of NEMA. This policy is more in line with the law and will be easier to follow in the field for both applicants

and Public Assistance staff. As addressed, the current guidance is not clear and difficult to follow in the field. This results in inconsistent drafting of project worksheets and results in inconsistent program implantation. These benefits will be important to emphasize in the communication with NEMA. The FEMA leadership briefing can be accomplished at the semi-annual meetings which includes the senior leadership of the state emergency management officials. This would be part of existing communication between the two organizations and the FEMA leadership brief is already a significant component of the semi-annual meeting. Follow up electronic communications with NEMA on the regulation changes will assist in clear and understandable communication of the proposed revisions in addition to continuing the valued partnership between the two organizations.

The next step will be to post the revised policy on the Federal Register as part of the Advance Notice Proposed Rulemaking process and allow a 30 day comment period. The draft regulation cannot be changed during this process but comments will have to be monitored in order to provide education and understanding to any organizations providing comments during the 30 days.

It is very naive to think the revision will be complete after the 30 day comment period without any negative comments. However, the process must take place and the comments will have to be evaluated in order to implement the regulation. It is also difficult to gauge the comments, both positive and negative, but those comments will have to be addressed with lawmakers and state emergency managers.

The process will likely involve additional rounds of the Advance Notice Proposed Rulemaking process. The process is slow and cumbersome and will require a one- to two-year focus period to achieve the changes to the 44 CFR and implementation of the proposed regulation.

Successful implementation will more closely align the law and regulation, allow facility owners the ability to manage their own risk through types of polices,

deductibles and maintaining insurance. And, the revised regulation will result in a more resilient community as facility owners are incentivized to mitigate damages in order to better protect their facilities before the next disaster. In the end, both communities and the taxpayer will benefit. Communities will benefit by increased resiliency. The taxpayer benefits by avoiding repairs to facilities in subsequent disasters and by the flexibility to manage risk more efficiently. The actual savings from the revision are impossible to estimate as the future damages to a facility cannot be predicted. However, the federal government has spent over \$22.4 billion on repairs to facilities (buildings and other insurable facilities) since Hurricane Katrina. Not all these funds would be a savings to the taxpayer but the \$22.4 billion frames the scope of the problem and magnitude of repairs to facilities from disasters.

## **F. CONCLUSION**

Insurance considerations are a complicated and multi-faceted problem. The law, regulation, and policy should provide guidance that promotes sound risk management while protecting the jurisdiction, the federal government, and the taxpayer. Steps are being taken to provide potential solutions to updating the insurance policies as related to FEMA's Public Assistance Program and correcting policy direction that has been inconsistent with law, regulation, and the intent of Congress. With only minor changes in policy and practice, a modified insurance policy can provide the appropriate cost effective, protection for the taxpayer, the facility owner, and the federal government.

The requirement for insurance or a reduction for insurance in the first event will establish better risk management in communities. Communities will be self-sufficient in risk management and insurance requirements regardless of the damages for events that result in a major disaster declaration or events that do not warrant a presidential declaration. The requirement of insurance or the reduction for a reasonable amount of insurance requirement will promote better



risk management for facility owners. A change in regulation will solidify this change in the requirement of insurance.

The requirements of the difference policy types will allow the facility owner the flexibility to purchase the types and extent of insurance they desire and will promote better risk management in that procurement. The result is better risk management, faster recovery, and improved resiliency of communities.

The eligibility of the second deductible with the recent rescission of the disaster assistance fact sheet better aligns the current law, regulation, and policy. However, the next step is further defining the role of the deductible whether from the first or a subsequent event. Ineligibility of deductibles promotes risk management that does not make the taxpayer financially responsible for a facility owner's risk management implementation and follows the intent of congress whereas federal assistance is supplemental to insurance. The decision on deductibles is a risk management decision. The taxpayer should not be liable for risk a facility owner chooses to take in the protection of permanent structures.

The insurance commissioner will always have a critical role in the implementation of insurance policy in FEMA's Public Assistance program. Current law and regulation codify the commissioners' authority. The insurance commissioner, the taxpayer, state government, and federal governments will have a stake in these changes. FEMA cannot require greater types and extent of insurance as certified a reasonable by the State Insurance Commissioner. However, deductibles would not be eligible under the recommended changes and federal share of assistance would be reduced for damages caused by a similar event within a 10-year period. These changes will stir controversy in the implementation. However, types and extent of insurance as defined in law and regulation do not include deductibles or federal share of assistance. Regardless, a partnership in the implementation of these sweeping changes is required for successful attainment of insurance regulations that promote protection of assets and comprehensive risk management.

Insurance considerations in FEMA's Public Assistance program need revision. Existing law, regulation, and policy are confusing and difficult to implement in the field. Implementing the changes addressed in this document will lead to communities that are more resilient and less reliant on federal assistance. Additionally, these modifications will lead to a federal policy that is cost effective to the facility owner, the state, the federal government, and, most importantly, to the taxpayer.

## IX. CONCLUSION

The resources and capabilities of the private-sector, including insurance companies, play an important role in encouraging mitigation and creating greater resilience in a community.<sup>370</sup>

The role of insurance in the complex approach to risk management has changed dramatically since Benjamin Franklin helped in the formation of the “Philadelphia Contributionship for the Insurance of Houses from Loss by Fire” in 1752.<sup>371</sup> In the early days of insurance, pricing risk due to fire was based on \$1 for brick structures or \$2 for framed buildings per \$100 of building value. Risk management today is a complex combination of risk control and risk financing.<sup>372</sup> Risk control being the mitigation measures of avoidance, loss prevention, and loss reduction and risk financing includes retention, noninsurance transfer of risk, and insurance. FEMA’s Insurance policy, to be successful, needs to support both risk control and risk financing.

In a holistic approach to risk management, insurance is a critical component. Insurance and risk management are essential in the economic recovery of communities following catastrophic events. Risk management, risk control and risk financing, from catastrophic damage is critical to recovery and the ability for the state, tribe, and local government as well as the community to function in the future. For public jurisdictions, an added layer of protection is afforded through the Robert T. Stafford Disaster Relief and Emergency Assistance Act.<sup>373</sup> Assistance under this Act is authorized after the President determines that an event is of the severity and magnitude to warrant a presidential major disaster or emergency declaration to support response,

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<sup>370</sup> Federal Emergency Management Agency, National Disaster Recovery Framework, September 2011, 21.

<sup>371</sup> NAIC, State Insurance Regulation, 2011, 2.

<sup>372</sup> Rejda and McNamara, *Disasters by Design*, 12.

<sup>373</sup> Federal Emergency Management Agency, *Public Assistance Policy Digest*, 41.

recovery, and mitigation.<sup>374</sup> The Act proclaims that disasters often disrupt the normal functioning of governments and communities and those special measures for reconstruction and rehabilitation of devastated areas are necessary to assist the efforts of the affected states and tribes in expediting the rendering of aid, assistance, and emergency services.<sup>375</sup> While the Stafford Act authorizes assistance to both individuals and public jurisdictions, the area of research of this work is focused on the buildings and other insurable facilities that would receive assistance under FEMA's Public Assistance program.

Government programs need to ensure jurisdictions are incentivized to properly manage their own risk and offer disincentives for the contrary. The moral hazard of insurance is as critical as the moral hazard of federal policy related to insurance. In other words, the federal policy on insurance in FEMA's Public Assistance program should provide incentives and disincentives for facilities owners to make the best possible risk management decisions for their own protection, not drive facilities owners to make risk management decisions based on the federal policy.

## **A. A REVIEW OF WHAT HAS BEEN COVERED**

Previous chapters have evaluated insurance policy as related to FEMA's Public Assistance program from the intent and guidance provided in law through the implementation of insurance guidance in administering obtain and maintain requirements. The research also explored creating incentives for hazard mitigation and building resiliency of communities to the four pillars of insurance that form the recommendations in the development of an insurance guidance that would promote the intent of Congress as delineated in the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

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<sup>374</sup> Federal Emergency Management Agency, *Public Assistance Policy Digest*, 2008, 124.

<sup>375</sup> The Stafford Act, Section 101(a)(2).

The Stafford Act provides adequate guidance on insurance and the intent of Congress on the role of insurance in FEMA's Public Assistance program. The guidance provided in the 44 CFR has not kept up with the industry since being drafted as an interim rule in 1991. The insurance section in the 44 CFR is dated and provides ambiguous guidance on insurance regulation. FEMA policy has changed with the rescission of the fact sheet "Insurance Considerations for Applicants." While the Public Assistance Guide, Public Assistance Digest, and the Disaster Assistance Policy on "Insurance Responsibilities for Field Personnel" address FEMA policy, the rescinded fact sheet provided the only policy level guidance on the eligibility of deductibles in a subsequent event. While the FEMA policy is under review, the recession leaves the current guidance provided in imprecise regulations, open to interpretation on the eligibility of deductibles in a subsequent event.

The second appeals and past rulemaking attempts help in framing the insurance mindset of the FEMA policy-makers. In addition, the moral hazard of insurance is important as policy revisions are considered in creating a policy that encourages applicants to have adequate insurance and make sound risk management decisions. Conversely, federal policy is critical as the insurance policy must not inhibit sensible insurance decision making for applicants.

The facility owner's decision on deductibles is a key component of managing risk in order to protect of a facility from an unexpected loss. Deductible decisions are a component of risk retention by a facility owner, as opposed to transferring risk to another party. Balancing retained risk and the insurance premium is part of the decision process in the overall risk financing of a facility, which includes the deductible and the protection of insurance.

While not considered a deductible, self-insurance or a self-insured retention incorporates the same decision-making in retaining risk. While the types of self-insurance may be cost effective, the insured has the responsibility for the retained risk, which may be all or part of the facility value.

FEMA's Public Assistance program currently reimburses applicants for a reasonable deductible from the first event and, in some cases, subsequent events. However, defining reasonable is not delineated and, in the complex world of risk management, reasonable may be becoming more difficult to define with the many retained risk and self-insurance options.

Facility owners have many decisions to make to the types of insurance policies that protect their facilities for a loss. For states, the most basic decision is to whether to purchase insurance, elect to self-insure and retain the risk of loss themselves, or enter the capital markets in the issuance of catastrophe bonds.

The election to self-insure requires notification to the President, which is delegated to FEMA, for review and approval of a self-insurance plan. The Federal Insurance Administrator has the final review and approval of the self-insurance plan for flood hazards, as addressed in the 44 CFR. For other than flood hazards, the state must either declare its election to self-insure in writing at the time of acceptance of assistance, or subsequently, and submit an established plan of self-insurance with supporting documentation for approval to FEMA's Assistant Administrator for Recovery. Therefore, for flood or other than flood hazards, states must make an election to self-insure and submit a plan for approval.

The commercial property industry is immense and has given rise to a wide variety of specialized options for facility owners.<sup>376</sup> These options are specialized, proprietary in some cases, and innovative in providing tailored insurance coverage to facility owners. Law and regulation must be broad enough to adequately address past, present, and future insurance needs for both flood and other than flood hazards.

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<sup>376</sup> New Appleman, *Insurance Law Practice Guide*, 2012, Matthew Bender & Company, a member of the LexisNexis Group, 31.06, § 41.01(2)(a)(i).

For flood, insurance requirements can be satisfied through three options. One, insurance policies purchased through the National Flood Insurance Program. Two, policies purchased through the Write Your Own program, which follow all terms and conditions of a Standard Flood Insurance Policy. Three, facility owners may elect to self-insure, which may include retained risk and commercially purchased insurance as a component of that coverage. As previously addressed, the election to self-insure requires review and approval of the plan.

For other than flood, insurance requirements can be met through self-insurance, as previously addressed, specific or single insurance policies, and blanket insurance policies covering all their facilities, an insurance pool arrangement, or some combination of these options. Blanket policies are defined in insurance law. However, insurance pool arrangement is not defined but seems to address all risk pools. The regulation intent appears to provide an option for facility owners to reduce cost and allow options in an efficient insurance arrangement from a risk management viewpoint. Conversely, the option to pool all facilities may not fully cover the previous deductible of the damaged facility. The intent of the regulation appears to offer the facility owner options while protecting the taxpayer.

The factors associated with the obtain and maintain requirement include the effect of a requirement on the grant, the State Insurance Commissioner, types of policies, deductibles, and timing of the commitment. The effect on Public Assistance grants is the requirement to obtain and then maintain insurance involves both the previous grant and the grant subsequent to the insurance requirement. The State Insurance Commissioner has broad authorities for other than flood perils and limited authority for eligible damages due to flood. The type of insurance policy has an impact on the disaster assistance provided on a facility with an obtain and maintain requirement,

whether a single policy, blanket, or pool arrangement. In addition, the timing of when the obtain and maintain requirement is indeed a requirement is unclear in policy.

Resiliency and hazard mitigation are critical in reducing the costs of future disasters and building communities that are more resilient. Federal encouragement can enhance resiliency and stress the importance of resiliency to local communities. Local based recovery approaches are most effective to the long term sustainability of communities.<sup>377</sup> Federal and state resources must assist communities incorporate resiliency and sustainability goals into their post disaster recovery planning both in technical assistance and in financial incentives. The Stafford Act provides a federal share of funding for both 404 and 406 mitigation measures. The Act also provides the disincentive for facilities where mitigation measures were not taken and the facility sustains a repetitive loss within a 10 year period.

Disasters happen—the risks cannot be completely eliminated.<sup>378</sup> The risks can be reduced through a more complete understanding of the value and importance of mitigation and resiliency. With the right financial incentives and disincentives for hazard mitigation, communities can be more resilient and better prepared to withstand an event and recover faster, stronger, and more cost effective.

Comparing the actions of other countries can be insightful in looking at our own methodology. In exploring similar programs in Australia and Canada, the declaration criterion for both countries provides less or no federal assistance in smaller disasters and increasing the percentage for larger events in a sliding scale. This increases the state, province, or territory participation in the smaller events. As a result, the policy emphasizes the importance of good risk

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<sup>377</sup> Mileti, *Disasters by Design*, 240.

<sup>378</sup> Federal Emergency Management Agency, *Mitigation and Insurance Strategic Plan 2012–2014*, 31.



management for public facilities and the accompanying insurance program. This creates an environment of resiliency of infrastructure for the jurisdiction's facilities with or without a Presidential declaration.

The programs being implemented in Australia and Canada as related to insurance can offer best practices and alternatives to the implementation of FEMA's Public Assistance program. One, the eligibility of deductibles should be reconsidered. Australia and Canada do not reimburse for deductibles. Only the U.S. reimburses applicants for deductibles. Two, FEMA will reimburse for damages for uninsured facilities in the first disaster. Australia and Canada make adjustments for uninsured facilities based on what was reasonably available (Canada) or based on the approval of an insurance assessment (Australia).

Both Australia and Canada appear to maintain a partnership with the insurance industry. The insurance industry is a beneficiary of the mitigation measures and emergency response efforts of emergency management. Australia cites two primary reasons for this partnership. The insurance industry can assist emergency management agencies with the necessary research and investment for improved hazard identification, risk assessment and mitigation efforts. In addition, insurance companies provide access to affordable insurance against disasters at affordable rates. This is especially true where mitigation measures have taken place.<sup>379</sup> This partnership could be an expansion area for FEMA in promoting more resilient communities with the U.S. insurers.

The U.S. can learn from the many facets of the insurance programs in Australia and Canada to make improvements and alter policy to ensure the U.S. policy places incentives on resiliency and risk management. These changes will ensure the protection of the taxpayer, the local jurisdictions, the state, tribal nations, and the federal government.

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<sup>379</sup> The Attorney-General's Department, Australian Emergency Management Arrangements, 2009, 11.

## **B. RECAP OF RECOMMENDATIONS**

The Department of Homeland Security's Office of Investigator General agrees in recent publications that the Stafford Act encourages states and local governments to obtain and maintain insurance. However, FEMA's program provides a disincentive to carry insurance and is silent on several important policy issues.<sup>380</sup> The Public Assistance program reimburses applicants in the first disaster regardless of insurance coverage, which provides a disincentive to carry insurance. In the second and subsequent events, applicants are required to obtain and maintain insurance coverage in the amount of the eligible disaster assistance. Current policy does not provide clear guidance on deductibles. Applicants are reimbursed for deductible amounts in insurance policies, regardless of the amount of the deductible thus providing a disincentive for a small or moderate deductible.<sup>381</sup>

The Public Assistance Program as related to insurance should be shaped to promote resiliency and sound practices of risk management in order to reduce the reliance on federal support following a major disaster. The program should be shaped in order to provide incentives and disincentives for insurance coverage that do not create a moral hazard in decision making to applicants or in the federal policy of insurance. Communities should have an incentive to recover faster from the first event in order to increase community resilience. And, the taxpayer's investment in a damaged facility must be protected in a subsequent event.

The Stafford Act addresses six important provisions as related to insurance. These provisions must shape policies related to insurance in the Public Assistance program.

- The intent of Congress with respect to insurance as defined in the Stafford Act is to encourage individuals and governments to protect

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<sup>380</sup> Beard, FEMA's Process for Tracking Public Assistance Insurance Requirements, 1.

<sup>381</sup> Ibid., 11.

themselves by obtaining insurance to supplement or replace government assistance;<sup>382</sup>

- The intent of Congress is to encourage hazard mitigation to reduce losses from disasters;<sup>383</sup>
- A requirement to obtain and maintain insurance as a condition of receiving PA grant funding;<sup>384</sup>
- A prohibition on duplication of disaster assistance benefits (from any source, including insurance proceeds);<sup>385</sup>
- Deductions from grant funding for certain uninsured facilities located in an SFHA;<sup>386</sup> and
- FEMA shall not require greater types and extent of insurance than are certified to him as reasonable by the appropriate State Insurance Commissioner responsible for such insurance.<sup>387</sup>

These six key provisions must shape the insurance policy in order to comply with the intent of Congress and the adherence to law as related to insurance. The four pillars that support these provisions are the requirement of insurance, types of insurance policies, eligibility of insurance deductibles, and promote resiliency and mitigation of future damages.

## **1. Pillar One: The Requirement of Insurance**

The recommended route is a layered approach in order to encourage facility owners to protect themselves by obtaining insurance to supplement or replace government assistance. The requirement of insurance would be defined through a multiple step review. First, does the facility owner have an insurance policy or a plan? As previously addressed, the decision to self-insure or have no insurance is a decision to retain the risk of loss to the insurable facility. Second, does the state or local jurisdiction have a minimum insurance level? The

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<sup>382</sup> The Stafford Act, Section 101.

<sup>383</sup> The Stafford Act, Section 101.

<sup>384</sup> The Stafford Act, Section 311(b).

<sup>385</sup> Ibid., Section 312.

<sup>386</sup> Ibid., Section 406(d).

<sup>387</sup> Ibid., Section 311(a)(2).

minimum insurance requirement would be defined in the hazard mitigation plan of the state or local jurisdiction. Third, if the insurable facility owner did not have an insurance plan or the applicable Hazard Mitigation Plan did not establish a minimum insurance level, an independent review panel would be convened by the Regional Administrator to establish the minimum amount of insurance that was reasonably available to the insurable facility owner. This review would be established by the Regional Administrator in determining the insurance that would have been reasonably available based on historical project level data. In addition, the federal share would be reduced to 25% in a subsequent event from damages from the same type of event within a 10 year period without the appropriate mitigation measures taken as a disincentive for the lack of any risk management.

## **2. Pillar Two: Types of Insurance Policies**

FEMA should not be concerned as to the type of insurance policy (self-insurance, blanket, scheduled, pooled, or other arrangement). The facility owner should not be limited in purchasing the types of insurance that best fit the facility owner's risk management requirements. The type of policy is a risk management decision and should be left to the facility owners. FEMA should be only concerned that a facility is protected by insurance or insurance like product in the first event when reasonably available and the federal investment is protected, when grant funding was provided to facility owner, in the subsequent event. The applicant should have the flexibility to manage their own risk in determining insurance requirements without undue burden to the taxpayer. This includes the ability of the applicant to select the type of policy that best fits their needs.

## **3. Pillar Three: Insurance Deductibles**

The Stafford Act is silent on deductibles. The Act does provide the insurance commissioner great authority as the "the President shall not require greater types and extent of insurance than are certified to him as reasonable by the appropriate State insurance commissioner responsible for regulation of such

insurance.”<sup>388</sup> FEMA’s February 8 memo rescinded Disaster Assistance Fact Sheet 9580.3.<sup>389</sup> While the memo addressed and re-stated several issues involving insurance, the memo has left many questions related to insurance deductibles. The memo permits the reimbursement of second deductibles for all policies except blanket insurance policies. The law is detailed in Section 311 of the Stafford Act on insurance.<sup>390</sup> Regulation is provided by Sections § 206.252 and § 206.253 of the 44 Code of Federal Regulations. Both sections require FEMA to reduce the eligible costs by the amount of insurance proceeds with exception of blanket policies.<sup>391</sup> Most would argue that insurance proceeds do not include the deductible, only the “check” provided by the insurance company.

Deductible decisions are a component of risk retention by a facility owner. The balance between retained risk and insurance premium is part of the overall risk financing of a facility, which include the deductible and insurance. In addition, the reimbursement of a deductible from a second or subsequent event is a duplication of benefits.

The proposed regulation in this document would not require greater types and extent than deemed appropriate and reasonable by the State Insurance Commissioner. Each facility owner will still be able to retain all the risk or as little of the risk they choose to retain. However, this proposed regulation would make deductibles ineligible for disaster assistance.

#### **4. Pillar Four: Resiliency and Hazard Mitigation**

Resiliency and hazard mitigation are the intent of Congress as delineated in the Stafford Act. However, current regulations need to codify the incentives for hazard mitigation, which will lead to improved resiliency. This can be

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<sup>388</sup> The Stafford Act, Section 311.

<sup>389</sup> Deborah Ingram, “Disaster Assistance Fact Sheet 9580.3, Insurance Considerations for Applicants,” Letter of February 8, 2013.

<sup>390</sup> The Stafford Act, Section 311.

<sup>391</sup> 44CFR, § 206.252 and § 206.253.

accomplished in current law but the regulation does not exist. The Stafford Act provides for a reduced federal share for facilities damaged on more than one occasion within a proceeding ten-year period by the same type of event and the owner of a facility has failed to implement appropriate mitigation measures to address the hazard that caused the damage to the facility.<sup>392</sup> The Act allows for the reduction of assistance to not less than 25 percent. Providing an incentive to facility owners to mitigate damages following a first event, the facility and the taxpayer are better protected in a subsequent event and would increase the resiliency of the facility and the community in subsequent events.

The use of mitigation would greatly increase resiliency in communities. The benefit to the facility owner and the taxpayer is substantial as the vulnerability of a community is reduced in a subsequent event. Providing an incentive to facility owners to mitigate in the first event, the facility and the taxpayer are protected in a subsequent event. While the Stafford Act permits a 25% federal share, the federal share should be stepped down over subsequent events when facility owner fails to perform mitigate measures. For example, the first event the federal share would be the normal 75% federal share (or 90% federal share in more catastrophic events consistent with current policy).<sup>393</sup> The second event would be no more than a 50% federal share for damages to the same facility for the same type of peril. The third event the federal share would be 25% federal share. The exception would be for facilities that do not have insurance or an insurance protection plan where the facility would only be eligible for 25% federal share in a second or subsequent event. Although the incentive is negative, reduced federal assistance in future events is a significant incentive to facility owners to mitigate damages in the first event and encourages facility owners protect themselves with insurance.

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<sup>392</sup> The Stafford Act, Section 406(b)(2).

<sup>393</sup> The cost share adjustment to 90% federal share is \$133 per capita (FY13) of federal assistance provided in a given state.

FEMA's insurance policy for the Public Assistance Program should consider affordability, adequate insurance, fairness, while promoting flexibility to the applicant and risk management decisions that are not based on the moral hazard of insurance or federal policy. The revision of regulation and policy will correct these deficiencies and create overall guidance that promotes effective management for the facility owner and the taxpayer.

### **C. ARE WE PREPARED FOR A “MAXIMUM OF MAXIMUMS” EVENT?**

If the recommended changes are made in correcting deficiencies in law, regulation, and policy on the role of insurance in FEMA's Public Assistance program are made, are we prepared for a catastrophic event? The answer is – the recommended changes are a start.

If the 1906 San Francisco earthquake occurred today, the damages would exceed \$400 billion with over \$200 billion of insured property losses; a repeat of the 1811–1812 New Madrid Fault sequence would cause potential economic damage of up to \$275 billion with insured losses of \$100 billion.<sup>394</sup>

For perspective, Hurricane Andrew made landfall in South Florida in 1992 causing insured losses of \$15.5 billion.<sup>395</sup> Losses from Hurricane Andrew contributed to the insolvency and closure of eleven insurance companies.<sup>396</sup>

Insurance and managing risk is critical at all levels, including the facility owner through the federal government. This approach includes insurance companies, the capital markets, states, and tribes as well as other risk management entities. The complexities of risk management involve, at a minimum, an awareness of the risks involved as you cannot control risk without

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<sup>394</sup> National Association of Insurance Commissioners, *Natural Catastrophe Risk: Creating a Comprehensive National Plan*, June 2009, 2.

<sup>395</sup> Gary Kerney, “20 Years Later: Insurance Changes Triggered by Hurricane Andrew,” *Insurance Journal* (August 21, 2012), <http://www.insurancejournal.com/news/southeast/2012/08/21/259960.htm>.

<sup>396</sup> Bill Churney and Nan Ma, “Twenty years after Andrew—How Far Have We Come?” <http://www.isopropertyresources.com/Feature-Story/Articles/Twenty-Years-after-Andrew-How-Far-Have-We-Come.html>.

understanding it. The insolvency and closure of eleven insurance companies highlight that even industry experts can fail in understanding the risks from a catastrophic event.

The National Association of Insurance Commissioners drafted a Comprehensive National Plan for catastrophic events in 2009. This approach involves multiple layers of protection to the country and proposes increasing risk bearing capacity.<sup>397</sup>

This plan focuses on increasing risk bearing capacity for all insurers and insurance companies that provide policies to both individuals, commercial properties, and public jurisdictions. The first layer of the Comprehensive National Plan stresses the importance of mitigation and the education and incentives to mitigate potential threats in addition to building pre-event capital reserves on a tax deferred basis. The second layer focuses on state support through the development of a state catastrophe fund, or the participation in a regional catastrophe plan, as back stop measure for the insurance markets and the establishment of effective building codes for the catastrophic exposures in the state including development of high hazard land use plans and establishment and implementation of effective mitigation measures. The third layer focuses on federal support through the establishment of a public/private risk pooling mechanism through a federal risk-based reinsurance program.

The draft plan covers components of the federal and state partnership in the establishment and enforcement of mitigation measures including building codes in the risk control of communities. The plan also raises the concern of the ability of public and private partnerships will be critical in the recovery from a catastrophic event. Awareness and identification of the risks at all levels is in order to establish effective risk control and risk financing measures.

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<sup>397</sup> National Association of Insurance Commissioners, Natural Catastrophic Risk: Creating a Comprehensive National Plan, Version 15a, June 2009.



Risk management for state, tribal, local, and non-profit organization facility owners is prudent for the protection of jurisdiction of assets. While managing risk occurs regularly by facility owners across all levels of jurisdictions eligible for Public Assistance, however, for the federal government, the visibility of the risks as a provider of supplemental assistance is unknown in the current environment. The requirement of insurance and the requirement to include insurance requirements in the hazard mitigation plan are critical to gaining visibility of risks over and above existing property protection and supplemental risks.

Insuring the risk of a maximum of maximum event requires a complex and diversified risk management portfolio, which includes insurance companies, capital markets, and government at the state and federal level. Federal policy needs to encourage creative risk management decisions and increasing risk bearing capacity to ensure the protection of public assets, not stymie creative solutions. Moreover, understanding the risk involved in a catastrophic event is important to better quantify the risks to the federal government and taxpayer. With an understanding of the risk from a catastrophic event, we, as a nation, can begin to assess the exposure to risk and begin to minimize that risk in order to reduce the costs of disasters across the country. The ability to better understand the risks and supplemental assistance is important to the federal government and the taxpayer, who ultimately the funder of last resort.

#### **D. CONCLUSION**

Insurance and the policy related insurance in FEMA's Public Assistance program is out dated and needs to be revised. The Stafford Act can support most of the recommended changes presented in this research. The only change is that the ability to self-insure should be expanded to include states, tribes, local governments, and select non-profit organizations. This change would allow all eligible applicants the ability to manage their own risk and create cost effective solutions in managing that risk. The 1991 interim rule on insurance can be greatly enhanced to allow for better risk control and risk financing. The four

pillars of insurance include the requirement of insurance, freedom to choose the types of insurance policies that best fit the facility owner, ineligibility of deductibles, and incentives for mitigation will greatly improve the existing insurance policy.

The Department of Homeland Security-Office of Inspector General (DHS-OIG) agrees and has expressed their viewpoint in the defining insurance policies and insurance requirements through their December 2011 report on insurance regulation. The report recommends that FEMA continue with proposed insurance requirement started in 2000 and explain whether local government or PNP organizations could qualify as a self-insurer for purposes of meeting the insurance purchase requirements. The report recommends that the rulemaking process begun in 2000 continue and that FEMA prepare and issue additional guidance for self-insurance, among other topics.<sup>398</sup> This is important in defining the type of policies available to public organizations that own state, local, tribal, or private non-profit facilities.

The net effect of these changes will encourage facilities owners to retain the appropriate risk in deductibles and self-insurance as federal assistance would not be available for these components of risk financing. The most likely scenario of the effect will be facility owners retaining less risk with lower deductibles for their facilities. While the limit of liability of insurance policies across the country may change, insurance requirement and risk management profiles defined in state and local hazard mitigation plans will assist in defining the risk that the federal government faces as the provider of last resort. The net effect could be a lower limit of liability as facility owners assess the appropriate risk profile. Most importantly, the risk profile and overall risk management of their facilities will be based on their assessment of that risk, not federal policy. By defining the risk above an insurance limit of liability in a transparent manner, we as a nation can begin to explore alternate measures to expand our risk bearing capacity to

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<sup>398</sup> Beard, FEMA's Process for Tracking Public Assistance Insurance Requirements, 13–14.

support state and local communities in a catastrophic event. This evaluation of risk can occur before a catastrophic event, not after it has occurred.

In a holistic viewpoint on risk, the end state of public policy on insurance needs to expand beyond the updating and revisions of public policy insurance. Planning for a catastrophic event needs to be part of that solution. As stated, the starting point is understanding the risk faced by the federal government and taxpayer. Today, this risk is undefined. In a catastrophic event, the federal government must provide assistance for an undetermined and uncapped amount of risk. By including an insurance requirement through the state and local hazard mitigation plans, we can begin the voluminous task of defining that risk, analyzing the exposure to the federal government and the taxpayer, and mitigating the risk through the partnerships of the private sector, local governments, state governments, and the federal government. By mitigating the risk to facilities across the country, we can begin to reduce the costs of disaster assistance. Law, regulation, and policy must be supportive to innovative solutions in support of responsible risk management in all our communities.

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